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TABLE OF CONTENTS

	Page
Letter of transmittal	XVII
Foreword	XIX

PART I

HIGH MORTALITY—FACTS AND FACTORS

CHAPTER I

Business revival	3
Use of terms	4

CHAPTER II

Business mortality in retail, craft, and service enterprise	7
Comparison of longevity	7
Mortality rank	11
Grocery store survivals	15
Other retail, craft, and service groups	18
Infant mortality	20
Variations with time	25
Size of community	29
Life span and net worth	31
Life span and sales	33
Population per store	36
Form of organization	40
Life expectancy	41

CHAPTER III

Business mortality in manufacturing	45
Longevity	45
Shifts with time	47
Size of community	47
Life span and net worth	48
Form of organization	49

CHAPTER IV

Comparison of mortality experience of various types of business	51
Longevity	51
Changes with time	55
Life span and net worth	56
Form of organization	59

CHAPTER V

Changes in business population	63
Birth rates compared	65
Tendencies in business growth	66
Failures	67
Short-period movement	69
Cycles of failures	71

CHAPTER VI

Business migration	73
Factors in industrial movement	75
Concentration	78
Prospectus	78

CHAPTER VII

	Page
Managerial competency as a factor in business mortality	81
Training and experience	81
Age of manager	84
Personality	85
Accounting records	85

CHAPTER VIII

Adequacy of capital	87
Fraud	87
Investment	88
Source of capital	91
Use of capital	95

CHAPTER IX

Control of assets and liabilities	97
Fixed assets	98
Receivables	99
Current assets	99
Realized assets	100
Secured liabilities	102
Installment debts	103
Finance company obligations	103
Obligations to wholesalers	103
Indebtedness for rent	103

CHAPTER X

Control of costs of operation	105
Overhead costs	105
Overhead and sales	105
Rent	106
Rent and sales	106
Pay roll	107
Pay roll and sales	108
Proprietor withdrawals and sales	108
Costs and prices: Margins	109
Inventory	112

CHAPTER XI

Control of sales, of markets, and of product	115
Sales volume	115
Sales effort	115
Cost of selling	117
Location	118
Channels of distribution	121
Competition	122
Products	124

CHAPTER XII

Credit as a factor in business mortality	127
Credit risks	127
Credit losses	128
The creditor and insolvency	133

CHAPTER XIII

Personal affairs complicating management difficulties	135
Incidence of personal factors	135
Illness and its costs	135

CHAPTER XIV

Page

Government regulation as a factor in business mortality 139
- Purposes of Government regulation 140
- Types of regulation 140
  - Control of entry into or expansion of business 141
  - Monopoly and practices in restraint of trade 141
  - Interstate and intrastate commerce 144
  - Regulation of marketing devices and practices 146
  - Regulation of price policies and practices 148
- Government aid to business 150
  - Gilt-edge invitations 150
- Summary 153

PART II

MARKET SECURITY AND PRICE STABILITY (SOME PHASES OF COMPETITION IN DISTRIBUTION)

Foreword to part II 157

CHAPTER XV

The struggle for marketing control 159
- Changing channels 159
  - Traditional methods 159
  - The new era 159
  - Marketing functions 159
  - Present pattern of marketing 160
  - Contestants in the struggle for control 161
  - Wholesalers 161
  - Manufacturers 162
  - Retailers 162
- Nature of the struggle 163
  - Competitive devices 163
  - Legislative action 163
  - Trade association activity 164
- Effect of the struggle on size 166
  - Size of manufacturing establishments 166
  - Size of wholesalers' establishments 167
  - Grocery trade 168
  - Drug wholesalers 169
  - Dry-goods wholesalers 170
  - Hardware wholesalers 170
  - Electrical-goods wholesalers 171
- Trends in size of retailing establishments 172
  - Changes in average size of store 173
  - Trends in size since 1929 174
- New developments in types of retailing 176
  - Chain stores 176
  - Super markets 179
  - Department stores 180
  - Mail-order houses 182
  - Consumer cooperatives 182
  - The independent retailer 183
- Profits in manufacturing, wholesaling, and retailing 184
- Summary and conclusion 187

CHAPTER XVI

Page

Resale price, maintenance—an economic summary 189
Definition and classification 189
Why proponents want legalization of resale price maintenance 189
Retailers 189
Wholesalers 191
Manufacturers of branded goods 191
Economic and social reasons for resale price maintenance 192
Arguments against resale price maintenance 193
Resale price maintenance laws in the United States 196
Difficulties and limitations encountered in the practice of price maintenance 199
Interrelationship with other factors 202
Conclusions 203

PART III

ADEQUATE LONG-TERM AND SHORT-TERM FINANCING

CHAPTER XVII

Capital and credit problems of small business 207
The financial position of small business 207
Short- and long-term debt 209
Present equity 210
The economic position of small business 211
Net income 213
Share of the market 216
Turn-over 218
Cost of capital and credit 219
Trade credit 221
Banking policy and the needs of small business 222
Equity capital 227
Present governmental aids 227
Reconstruction Finance Corporation 228
Reconstruction Finance Corporation procedure 229
Results 229
Federal Reserve loans to industry 231
Provisions of section 13b 231
Regulation "S" 231
Loans and commitments made 232
Results claimed for the Federal Reserve industrial loan program 234
Comparison of Reconstruction Finance Corporation and Federal Reserve loans to industry 234
Suggested aids 236
Equity capital proposals 237
Direct loan proposals 237
Insurance proposals 238
Summary and conclusions 239

CHAPTER XVIII

The financial problem of small business 245
Introduction 245
Definition of terms 246
The number of small enterprises 248
Number of business units 248
Numerical distribution of business units according to size 248
Marginal and part-time enterprises 249
The non-employing enterprises 249
The employing enterprises 249
Distribution in manufacturing 250
Distribution of corporations 250

The financial problem of small business—Continued | Page
Prevalence and characteristics of small business — 251
Trade — 251
Service — 252
Construction — 253
Manufacturing — 253
Mining and quarrying — 255
Transportation and public utilities — 256
Economic contributions of small business — 256
Service to the consumer — 256
Contributions to big business — 256
Competition with big business — 257
Contribution to gainful employment — 258
The financial position of small business — 260
Capital, credit, and small business — 261
Summary of findings — 261
Sources of equity capital — 262
Individuals — 262
Investment banking — 262
Investment trusts — 262
Sources of credit — 265
The commercial banks — 265
The Federal Credit agencies — 269
The accounts financing companies — 270
The factor — 272
The trade credit — 274
Others — 276
Conclusion — 276
Appendix I: Statistics — 281
Preface: Sources of information — 281
Estimated total number of business establishments — 282
Business units distributed by size — 283
Size measured by total assets — 283
Size measured by number of employees — 284
Size measured by value of product — 285
The habitat of small business — 286
Economic contributions of small business — 288
Appendix II: Field studies — 303
Explanatory note — 303
New England area: Fall River, Mass — 303
Consumer income — 303
The textile industry — 304
The new industries drive — 305
Retail business — 307
Banks and bank credits — 309
Non-bank money lending — 311
Middle Eastern area: Scranton-Wilkes Barre, Pa — 312
Some of the financing devices employed in the community — 312
Factoring in the silk industry — 314
Community attempts at capital relief — 316
Capital for new enterprises — 317
Great Lakes area: Detroit, Mich — 318
Equity and venture capital — 318
The credit situation — 319
Summary of 67 case studies — 321
Some specific cases — 322
Middle Western area: Omaha, Nebr — 324
Manufacturing in Omaha — 324
The cash basis in enterprise — 325
The commercial banking situation — 325
The problem of succession — 327
Omaha's community business fund — 327

	Page
Appendix II: Field studies—Continued	
Rocky Mountain area: Denver, Colo	328
The multiplicity of small banks	328
Summary of the capital and credit needs of 81 concerns	329
Some Denver case studies	330
Concerns financed by manufacturers	332
Pacific Northwest area: Seattle, Wash., and Portland, Oreg	333
The waning big-business base	334
The bases for new developments	334
Manufacturing	335
The need for capital loans	336
Seattle: The banking situation	337
Portland: Influence of branch banking	340
Substitute forms of financing	340
Experience of a community fund	341
Southwestern area: Dallas-Houston, Tex	341
Economic basis of the boom	342
Need of new manufacturing	343
Abundance of regional savings	343
Investment of regional savings	343
Limitations upon commercial credits	345
Some illustrative cases	345
Appendix III: Special studies	347
A medium-size finance company	347
A finance company of major size	350
An investment company and intermediate-size business	353
An experiment in venture financing	356
Viewpoint of a conservative commercial banker	363
Legislative proposals	364
Index	371

SCHEDULE OF TABLES AND CHARTS

PART I

TABLES

Page

1. Life span combined retail groups—percent of concerns discontinuing at given age — 8
2. Life span of retail grocery stores—percent of concerns discontinuing at given age — 9
3. Life span of retail drug stores—percent of concerns discontinuing at given age — 10
4. Life span of restaurants—percent of concerns discontinuing at given age — 10
5. Length of life of retail firms in three Minnesota cities—1926–30 — 11
6. Survival of retail enterprises in 32 county-seat towns—1915 and 1935 — 12
7. Life span of retail enterprises established in Poughkeepsie between 1844 and 1926 — 13
8. Business mortality of retailers commencing business in 1927 in 142 Colorado towns — 13
9. Business mortality of retailers in 142 Colorado towns, 1926–35—classified by 10 retail trades — 14
10. Mortality of retailers in 11 trades in 255 Illinois towns — 14
11. Business mortality of retailers in Colorado and Illinois — 15
12. Percent distribution of 1,169 independent grocery stores according to date of present ownership—Buffalo — 16
13. Accumulated percentage of deaths by year periods, grocery stores in Austin, Tex. (1880–1932) — 17
14. Mortality of independent grocery stores in Fort Wayne — 17
15. Turn-over, closing, and opening rates for chain grocery stores in Boston, 1929–32 — 18
16. Length of life of specific crafts established in Poughkeepsie between 1844 and 1926 — 19
17. Length of life of specific kinds of service enterprises established in Poughkeepsie between 1844 and 1926 — 19
18. Rate of turn-over of meat markets and combination stores in Chicago — 20
19. Percentage distribution of stores in business in Chicago in 1933 — 20
20. Infant mortality as percent of entrances of preceding period grocery stores, Austin, Tex — 21
21. Relation of infant mortality to total mortality by periods, from 1882 to 1932—Grocery stores, Austin, Tex — 22
22. Changes in numbers of individually owned retail meat stores in Chicago — 22
23. First year mortality of retail meat markets, Chicago — 23
24. Chicago retail meat stores entering each year classified according to length ofl ife—percentage discontinuing in each successive year — 23
25. Buffalo grocery store entrances each year classified according to length of life—percentage discontinuing in each successive year — 24
26. Buffalo drug store entrances each year classified according to length of life—percentage discontinuing in each successive year — 24
27. Buffalo hardware store entrances each year classified according to length of life—percentage discontinuing in each successive year — 25
28. Length of life of retail business enterprises in Poughkeepsie in 3 30-year periods, 1844–1933—cumulative percentage distribution — 25
29. Closures during period as percent of stores at beginning of period—Austin — 26
30. Turn-over of grocery, drug, hardware, aad shoe firms, Buffalo — 27
31. Mortality of firms in the hardware, shoe, drug, and grocery trades, Pittsburgh — 27

Page

32. Effect of decline period of depressions upon infant mortality—grocery stores, Austin, Tex 28
33. Effect of recovery period of depressions upon infant mortality—grocery stores, Austin, Tex 28
34. Infant closures as percent of total closures during six depressions—grocery stores, Austin, Tex 28
35. Variations in first year mortality 29
36. Business mortality of retailers in 10 trades in 142 Colorado towns, 1926–35 30
37. Turn-over or mortality of retail stores in 11 trades in 255 Illinois towns, arranged according to size of towns, July 1925, to July 1930 30
38. Number of retail firms in three Minnesota cities 31
39. Five-year turn-over ratios of retail firms in three Minnesota cities, classified by net worth, 1926–30 32
40. Life span of Chicago meat stores, classified by net worth, 1920 32
41. Sales per independent grocery stores in 1929 according to years of ownership 33
42. Number, of independent grocery stores, percent of total stores and percent of total sales by size of business 1929, 1933, and 1935—Buffalo 34
43. Sales of independent grocery stores identical in address, 1929, 1933, and 1935, as a percentage of 1929 sales, by size of business in 1929, Buffalo 35
44. Comparison of size and longevity of different types of enterprise—Poughkeepsie 36
45. Comparison of size and longevity of different kinds of business—Poughkeepsie 36
46. Comparison of population with stores in existence, Austin, Tex 37
47. Numbers of Chicago retail meat stores by type of operation 38
48. Number of retailers in 10 trades in 142 Colorado towns per 1,000 population, 1926 and 1935 39
49. Average number of retail stores for each 10,000 people in 1925 and 1930 for 11 retail trades in 154 Illinois towns 39
50. Number of inhabitants of Fort Wayne in proportion to the number of retail grocery stores each year, 1915–30 and 1889–1904 40
51. Comparison of length of life of corporations and all forms of retail enterprises, Poughkeepsie, 1844–1927 41
52. Life expectancy in Pittsburgh (1925–33) 42
53. Life expectancy in Buffalo (1920–28) 42
54. Probability of a store's remaining in business an additional year beyond any given age—Buffalo, 1920–28 43
55. Life expectancy in Austin—survivals out of 1,368 retail grocery stores 43
56. Life expectancy—retail grocery stores in Austin, Tex.—age to be expected, on an average 43
57. Life expectancy of individually owned, Chicago retail meat stores (computed according to their experience between 1920 and 1933) 44
58. Length of life of manufacturing enterprises in Poughkeepsie between 1844 and 1926 46
59. Length of life of manufacturing enterprises in Poughkeepsie between 1844 and 1926 46
60. Length of life of business enterprises in Poughkeepsie in three periods, 1844–1933 47
61. Number of manufacturing firms in three Minnesota cities—classified by net worth, 1930 48
62. Number of manufacturing firms closed in three Minnesota cities—classified by net worth, 1926–30 48
63. Form of organization—Poughkeepsie manufacturing enterprises 49
64. Length of life of corporations compared with all forms of Poughkeepsie manufacturing concerns, 1844–1927 49
65. Length of life of wholesale enterprises in Poughkeepsie, 1844–1927 51
66. Mortality by type of business, Minneapolis, St. Paul, and Duluth, 1926–30 52
67. Average life span by type of business, Minneapolis, St. Paul, and Duluth, 1926–30 52
68. Percentage distribution of closing and of opening enterprises, Minnesota, cities, 1926–30 52

Page

69. Length of life of business enterprises established in Poughkeepsie between 1844 and 1926 ... 53
70. Length of life of business enterprises established in Poughkeepsie between 1844 and 1926 ... 53
71. Business enterprises established in Poughkeepsie between 1844 and 1916 and lasting more than 20 years ... 54
72. Number of geople per business establishment—Poughkeepsie ... 55
73. Length of life of business enterprises in Poughkeepsie in three 30-year periods, 1844–1933 ... 55
74. Number of business firms in three Minnesota cities classified by type and net worth, 1930 ... 56
75. Average life of business firms in three Minnesota cities classified by net worth, 1926–30 ... 56
76. Number of business firms closed and opened in three Minnesota cities classified by type and net worth, 1926–30 ... 58
77. Five-year turn-over ratios of business firms in three Minnesota cities classified by type and net worth, 1926–30 ... 59
78. Form of organization, Poughkeepsie ... 60
79. Comparison of length of life of corporations and all forms of business enterprises, Poughkeepsie, 1844–1927 ... 60
80. Percentage distribution of types of organization before and after change (first 6 months of 1936) ... 61
81. Changes in retail population by quarters—January 1936–September 1937 ... 63
82. Business disappearances and business failures, by major divisions of industry, January 1936–September 1937 ... 64
83. Distribution of business births and deaths by industrial divisions (data for first 6 months of 1936) ... 64
84. Relative changes in enterprises by industrial divisions (data for first 6 months of 1936) ... 64
85. Probable birth rate ranking of divisions of industry (data for first 6 months of 1936) ... 65
86. United States business population ... 66
87. Changing percentages of all concerns represented by new and discontinuing enterprises ... 66
88. Commercial failures: Number and assets and liabilities ... 67
89. Failures by divisions of industry—yearly totals 1938 and 1937 ... 68
90. Bankruptcy liquidations—1920 to 1937 ... 69
91. Insolvency index 1895–1938—apparent annual number of failures for each 10,000 listed commercial enterprises ... 70
92. Fluctuations in tenancy (square feet of rental area changes between Oct. 1, 1938, and May 1, 1939) ... 70–71
93. Vital statistics for 13 durable and 11 semidurable goods industries 1929 and 1933 ... 78
94. Comparison of number of Poughkeepsie business concerns in homes and in separate building, 1873–76 ... 84
95. Accounting records of New Jersey and Boston bankrupt firms ... 86
96. Percentage of Chicago meat stores in each capital-rating group and percentage continuing in business over 5 years ... 89
97. Individual investment of operations in year of first entry into business, 1904–36 ... 91
98. Percentage of amounts of total liabilities in particular debt categories—individual proprietors ... 93
99. Sources of original capital, New Jersey and Boston bankrupts ... 94
100. Proportion of personal loans for business purposes ... 94
101. Business borrowers from Pennsylvania personal finance companies ... 95
102. Ratio comparisons of successful and failed concerns—piano manufacture ... 97
103. Scheduled assets of 570 bankrupt enterprises (excluding real estate) ... 98
104. Scheduled assets of 11 failed drug stores compared to realized assets and disposition of realized assets, St. Louis, 1925–31 ... 101
105. Scheduled liabilities of 570 bankrupt Boston enterprises (excluding collateral and real-estate mortgages) ... 102
106. Percentage of all proprietors with particular types of indebtedness ... 104
107. Percentage of amounts of total liabilities in particular debt categories—individual proprietors ... 104

		Page
108.	Percentage total overhead of total net sales	105
109.	Percentage business rent of total net sales	107
110.	Percentage pay roll of total net sales	108
111.	Percentage withdrawals of total net sales—individual proprietors	109
112.	Variations in weekly amounts sold to different types of retailers—the experience of a meat wholesaler in a large city	116
113.	Number of customers, number of orders, and total dollar sales of three branch houses for 5-year period, 1926–30	116
114.	Customer mortality—percentage lost and rate of customer turn-over	117
115.	Functional distribution of expenses: A typical wholesale unit, 1929	117
116.	Profitableness of different customers classified by amount purchased weekly	118
117.	The size of the headquarters city and its relationship to sales volume, expenses, and earnings	120
118.	Proportions of different products sold to small and large buyers—four wholesalers, 1932	124
119.	Relationship of product expense to volume per item and per interview (in percentages of average)	125
120.	Comparison of insolvent and successful firms—cotton textile industry	128
121.	Average credit losses of Philadelphia and Louisville grocers, 1928—credit losses as percentage of credit sales classified by amount total sales	129
122.	Bad-debt losses as percent of total credit sales	130
123.	Number and amount of bad debt losses (three branch houses—5-year period)	130
124.	Number and amount of bad debt losses according to length of service life	131
125.	Customer characteristics according to type of business	131
126.	Customer characteristics according to size of store	132
127.	Customer characteristics according to size of first-month purchases	132
128.	Chain stores and independent markets compared	133
129.	Percentage of bankrupt concerns affected by adverse domestic and personal factors	135
130.	Cost of illness in 34 New Jersey cases	135

PART II

TABLES

1.	Grocery wholesalers—general line	169
2.	Drug wholesalers—general line	170
3.	Dry-goods wholesalers—general lines	171
4.	Hardware wholesalers—general line	171
5.	Electrical-goods wholesalers—general line	172
6.	General summary of retail trade, 1929, 1933, 1935	174
7.	Percentage of distribution of retail stores and sales, by size of store, 1929, 1933, 1935	174
8.	Trends in retailing as shown by department-store sales, stocks, and collections; mail order; variety store; rural store; and automobile sales, 1929–37	178
9.	Number of chain stores and full-year sales, 1922, 1926, 1928	178
10.	Department-store sales, 1929–38	182
11.	Net operating results, percentage of sales, in department stores, 1930–37	182
12.	Profit as percentage of total capital wholesale, retail, and manufacturing corporations, 1924–28	185
13.	Manufacturing corporations—profit as percentage of total capital selected industries, 1924–28	186
14.	Wholesaling corporations—profit as percentage of total capital selected trades, 1924–28	186
15.	Retailing corporation—profit as percentage of total capital selected trades, 1924–28	187

PART III

TABLES

Page

1. Aggregate volume of working capital in manufacturing industries... 208
2. Current ratios for corporations in all manufacturing combined, in manufacturing textiles and their products, and in trade, 1932 and 1936... 209
3. Ratio of current liabilities to total borrowed capital for corporations in all manufacturing, in manufacturing textiles and their products, and in trade, 1932 and 1936... 209
4. Ratio of equity to total assets for all manufacturing corporations, 1932 and 1936... 210
5. Percentage changes in equity ratios for manufacturing corporations... 211
6. Failures by industrial groups and size of liabilities... 212
7. Proportion of smallest corporations to total corporations, 1931–36... 213
8. Proportion of smallest and largest deficit corporations to total corporations in each group... 213
9. Relationship of smallest deficit corporations to total corporations with and without net income... 214
10. Ratio of compiled net profit (after tax) to net worth (average equity) manufacturing industries—average, 1931–36... 214
11. Ratio of compiled net profit (after tax) to net worth (average equity) in three manufacturing industries—average, 1931–36... 215
12. Ratio of compiled net profit (after tax) to net worth (average equity) all corporations, average, 1931–36... 216
13. Stores and sales by size of stores—1935... 217
14. Gross sales (or gross receipts from operations) all manufacturing corporations submitting balance sheets, 1932 and 1935... 217
15. Turn-over ratio in manufacturing corporations submitting balance sheets, 1932 and 1935... 218
16. Average size of commercial loans made at different rates by groups of banks... 219
17. Expense of security flotation by size of issue (first 6 months of 1937)... 220
18. Distribution of commercial loans by interest rate charged (September 1–15, 1938)... 220
19. Interest income from loans of national banks (as percentages of total loans)... 220
20. Business loans of agencies whose charges exceed normal banking rates... 221
21. Applications for funds rejected by banks... 223
22. Reasons given by banks for refusal of loans... 224
23. Borrowing establishments classified by size and credit ratios, showing the percentages that reported credit difficulty in each size and ratio group, 1933... 225
24. Total loans and authorizations of the R. F. C. to business enterprises, February 2, 1932, to June 30, 1939... 230
25. Applications received and approved by Federal Reserve System, 1934–39... 232

APPENDIX I

TABLES

1–A, 1–B, 1–C. Estimated total number of business establishments.... 282–283

2. Size-group distribution of corporations in manufacturing, trade, service, construction, and mining and quarrying, by total assets, 1936... 284
3. Size-group distribution of 1,809,819 employing organizations, by number of employees on last day or last pay roll of March 1938... 285
4. Size distribution of 166,794 manufacturing establishments, by value of product in 1937... 285
5. Number of units, capital assets, and gross sales of small, intermediate, and large business corporations in major divisions of industry, 1936... 286
6. Number of units, capital assets, and gross sales of small, intermediate, and large business corporations in subdivisions of manufacturing, 1936... 287–288

Page

7. Number of workers employed per $100,000 of value added by manufacture in small, intermediate, and large manufacturing establishments, classified according to size of annual value of product, 1937 — 288
8. Investment in capital assets by small, intermediate, and large manufacturing corporations, classified according to size of total assets, 1936 — 289
9. Debt and types of debt, for 290,118 business corporations, by total assets size groups, 1936 — 289
10. Surplus and undivided profits, less deficits, and combined net profit or loss, for 290,118 business corporations, classified by size of total assets, 1936 — 290
11. Total number of business establishments in relation to total population of the United States, 1901–38 — 290
12. Estimated receivables of all consumer credit agencies in the United States, at the close of each year, 1923–37, by major classes of creditors — 291
13. Turn-over in the number of active business establishments, and business discontinuances involving losses, 1930–36 — 291
14. Number and percentage of small, intermediate, and large business corporations earning net income classified by size of total assets, 1932–36 — 291
15. Costs of flotation of 350 security issues registered under the securities act of 1933 during 1936 and 1937; classified by size of security issue — 292
16. Sales record of securities registered in 662 statements under the Securities Act of 1933 on Forms A–1 and AO–1 between July 27, 1933, and June 30, 1938; by quarterly periods of effective registration — 293
17. Sales record of securities registered in 662 statements under the Securities Act of 1933 on Forms A–1 and AO–1 between July 27, 1933, and June 30, 1938; by industry and size of issue — 294
18. Data on loans and advances made by Federal Reserve banks under section 13b of the Federal Reserve Act — 296
19. Applications for industrial advances (including commitments) approved by Federal Reserve banks under section 13b, classified according to size; June 19, 1934, to December 29, 1937 — 297
20. Applications for industrial advances (including commitments) under section 13b, classified according to business and industries; June 19, 1934, to December 29, 1937 — 298
21. Amount of business loans authorized by Reconstruction Finance Corporation under section 5d, section 5, and under the act of April 13, 1934; 1934–February 29, 1940 — 299
22. Number and amount of business loans authorized by Reconstruction Finance Corporation, classified according to size; as of February 29, 1940 — 300
23. Number and amount of business loans disbursed by Reconstruction Finance Corporation, by size of loan; as of February 29, 1940 — 300
24. Number of business enterprises to which loans were authorized by Reconstruction Finance Corporation, together with amounts authorized and disbursed, classified by industries; as of February 29, 1940 — 301

CHARTS

I. Trend of retail sales, 1929–39 (inclusive) — 173
II. Stores and sales by size of business groups, 1929–1933–1935 — 175
III. Trends in retailing, 1929–38 — 177
IV. Chain-store sales proportions, 1929–37 — 177
V. Department-store sales, 1929–40 (unadjusted) — 181
VI. Relation of operating expense and sales volume, data for 1933 — 181
VII. Mail-order and store sales, 1929–40 — 183

LETTER OF TRANSMITTAL

Hon. JOSEPH C. O'MAHONEY,
Chairman, Temporary National Economic Committee,
Washington, D. C.

MY DEAR SENATOR: By request of the Subcommittee on Printing and Review of the Temporary National Economic Committee, these materials on small business are collected together in one volume. They comprise detailed but scattered probings into special phases of certain small-business problems.

Under the title, "Some Problems of Small Business," are included studies on "High Mortality, Facts and Factors" (pt. I); "Market Security and Price Stability" (pt. II); and "Adequate Long-Term and Short-Term Financing" (pt. III). Part I represents an exhaustive compilation of the available segments of information on business mortality. Part II gives a highly sketchy and fragmentary analysis of the struggle for marketing control together with a brief summary of certain facts on resale price maintenance. A deeper probing of the efforts of small business to control price-cutting was not undertaken because of the fortunate circumstance that the Federal Trade Commission undertook as a part of its regular activities in 1939 to make an elaborate field study of the problem. It will soon publish an authoritative report. Part III presents two studies on the financial problems of small business, one summarizing the available fragments of information on the problem, the other, that of the Securities and Exchange Commission, breaking wholly new ground by giving the results of an actual field study.

The careful reader will note that the reports, in some respects, come to opposite findings and to varying conclusions. No effort was made to reconcile differences either between the research workers or their results. The subject at issue has given rise to no small amount of well-grounded differences of opinion and judgment, differences reflecting independent, self-reliant thinking of too substantial a value, at least in governmental research work, to risk curbing in the interests of uniformity and consistency of findings and recommendation.

Respectfully submitted.

THEODORE J. KREPS,
Economic Adviser.

SEPTEMBER 10, 1940.

FOREWORD

In some industries, obstacles to the establishment of a business enterprise are apparently insurmountable. In others, entrance is easy enough but survival is the real difficulty. This report brings together in one spot the many fragments of information now available concerning the problem of business mortality. Its two main sections relate to the causes of business failure and the degree of survival which results therefrom.

The material makes it very clear that business mortality is a problem of major proportions. In study after study, in industry after industry, in area after area, the record is the same. The chance of a newcomer becoming an established member of the business community is sadly slight. He carries on until his funds are exhausted, and then disappears from the scene. His place is taken by another hopeful, certain that he has abilities which will permit him to succeed where his predecessor has failed.

Perhaps the high rate of turn-over is the price which must be paid for the maintenance of freedom of enterprise. The fact remains that it is a price, and there may be ways of reducing its incidence. Consideration of the record here presented should yield clues as to possible steps which can be taken, without disturbing the basic purpose of a free economy.

Basic information relative to these problems is extremely meager. We are dependent upon studies of small fragments of the business population, with few tests as to their representativeness even of the smaller business enterprise. However fragmentary, the effort is made here to piece them together. A further difficulty is that, all too often, we have no record of the characteristics of the total population with which to compare the nature of the cases of failure.

Valuable assistance in assembling information was given Dr. Cover by Miss Glory F. von Hellens and Mr. Rudolph Matthes.

WILLARD L. THORP.

WASHINGTON, D. C., *March 1, 1940.*

PART I

HIGH MORTALITY—FACTS AND FACTOR

CHAPTER I

BUSINESS SURVIVAL

Survival in the struggle of business enterprises for existence is precarious, and the rate of turn-over amazingly high. Establishment of a concern and the entrance of an individual into business are usually accompanied by the naive optimism of inexperience. Unaware of the odds against them, and largely ignorant of the weapons of trade, prospective proprietors march stolidly to the ambush.

Resultant business mortality frequently destroys the morale of the enterpriser, liquidates the investment, undermines the working capital structure of the creditor, and seriously raises the question of the adequacy of our economic control.

Since discussion of the causal factors involved is offered in subsequent chapters, it is sufficient in this connection to emphasize the regularity of failure over more than a half century of business history. It is not a new experience, nor the result of a current emergency. Neither is it primarily a phenomenon of cyclical depressions. A descriptive phrase which might indicate the persistence of business dissolution is the stability of mortality.

Some variation in experience occurs in different sections of the country, in different fields of business, and under changing business conditions, but the long-time trend of disillusionment is impressively constant.

Some illustrations are pertinent.

Should conditions of business averaging the experience of the last 50 years prevail, about 7 of each 10 new grocery stores opening today will survive into their second year. Only 4 of the 10 may expect to celebrate their fourth birthday. However, for the stores surviving 2 years, prospects of continuing through 2 more years are brighter. With infant diseases successfully thwarted, two-thirds of these stores should span the 4-year period.

Only 1 of every 100 grocery stores entering business may expect to attain the very old age of 35 years. But of the stores that already have enjoyed 10 years of life, 6 of each 100 should live through 35 years.

Manufacturing and wholesaling enterprises survive, on an average, for longer periods than retail, craft, or service concerns.

One study of mortality in the Middle West records the average life span of manufacturers as 8 years, ranging from 63-year graybeards in the printing industry to the ephemera of the music and radio field, less than 3 years. Among wholesalers, with an average span of 7.5 years, the range was less—from 30 years in the printing and paper industry to 3 years in construction machinery. Retailers survived, on an average, 6 years, with lumber concerns averaging almost 14 years, building supplies only 2.5 years.

In Poughkeepsie, records of 70 years disclose the survival of only 10 percent of all establishments for a period exceeding 20 years. Wholesalers' life span averaged 16.7 years, manufacturers 12.6 years, and retailers 9.9 years; craft and service groups had still lower survival rates.

A study based upon United States census data for the city of Buffalo disclosed that of retail grocery stores surviving under the same ownership at least from 1929 until 1935, only 8 percent were established in 1929. Of those not recorded as in business in 1933 or 1935, 36 percent were established under the designated ownership during 1928 and 1929—an illustration of infant mortality.

More than 50 years of retail grocery turn-over records of Austin, Tex., indicate that first- and second-year closures constituted almost 51 percent of all discontinuances.

From Pittsburgh records of the period, 1925–34, almost a complete turn-over of establishments would be expected in the retail grocery trade in 5 years. Eleven years would be required in the drug field, 6 in the shoe trade, and 10 in the hardware retail business.

Rapid population growth in a community appears to overstimulate entrance into business with resultant high turn-over rate. However, viewed over a long period of time, it is probable that the number of customers per store is increasing.

During a period of decline in business, since new proprietors tend to postpone entry and liquidations are delayed as long as possible, closures tend to decline. During a recovery period, with more optimism displayed by potential owners and with a large group of delinquents failing to reestablish solvency, closures increase. Changes in numbers and rates vary with the incidence of the depression and with the relative stability of each particular trade group.

The corporate form of organization is relatively more successful in survival, particularly during the early years of business. Most corporate units are larger than individual proprietorships or partnerships, and the size and credit factors may yield an advantage in the conduct of business. However, it is possible that this advantage disappears after about 5 years of existence, since larger sized individual proprietorships tend to survive, as well. The average life of all failing firms in three Midwest communities was 6.6 years. Those establishments with net worth of less than $2,000 survived, on an average, 5.2 years, and those with investment of from $2,000 to $10,000, 9.4 years. Life spans were longer for firms of higher net worth, reaching an average of 33 years for firms with half a million or more investment. From Buffalo records it is suggested that the survival rate of the larger firms is greater than of the smaller, due not so much to the growth of small firms into large concerns as to the elimination of the weaker small units.

USE OF TERMS

The term "survival" is used to indicate continued existence of an establishment beyond the life of another enterprise, or through a particular event such as a business depression, or a specific date.

Mortality indicates cessation of a business or of a group of concerns. Business mortality rate, or turn-over, denotes the proportion

of decedent establishments to all business enterprises or other given base.

Discontinuance, disappearance, closure, and demise are inclusive terms used in connection with cessation of a business, with no commitment as to method or cause. An establishment may have discontinued or closed due to circumstances as widely divergent as failure or the retirement of a successful proprietor. If information is sought in a directory, the name of a concern once listed may have disappeared, or be missing, subsequently.

Insolvency is the condition of a concern unable to pay all debts at a particular time.

Liquidation is the process of discontinuing business by disposal of assets and complete or partial satisfaction of claims.

Failure is used principally to indicate withdrawal from business as the result of inability to make a profit. The Dun & Bradstreet connotation requires some loss to creditors.

Bankruptcy is a Federal legal process by which a debtor is declared insolvent, his assets seized and distributed among his creditors, after which he is formally discharged of further liability.

Receivership is a legal device for the management and conservation of business property over which there is a dispute; a receiver appointed by and responsible to a court endeavors to reestablish or protect solvency and to defend the interests of investors and creditors.

Establishment, concern, and enterprise are general terms referring to business units, as distinct from the terms "firm, proprietorship, partnership or corporation," which have legal ownership connotations.

CHAPTER II

BUSINESS MORTALITY IN RETAIL, CRAFT, AND SERVICE ENTERPRISE

Entry into many fields of retailing is so easily accomplished and the competitive struggle so severe that a continuous seething occurs in the cauldron of trade. Prospective, undiscerning proprietors appear to be ready to step into the place of fallen comrades.

No study of variations in the length of life enjoyed by American business has been made for the country as a whole, and, of the local estimates, concentration has been upon the retail field. Many problems arise in following the identity and experience of the individual firms and in deriving comparisons of separately conducted studies of mortality.

Among the principal problems involved in analyzing the case histories of firms as a basis for calculating life span are the following: (*a*) Change in name of the enterprise; (*b*) change in the form of organization, such as from partnership to corporation, sometimes under the same proprietorship; and (*c*) change of location of the establishment including migration to a different community.

Additional difficulties in attempting comparison of independent studies of mortality include: (*a*) Varied sources and classification of records; (*b*) period of time represented; (*c*) date of entry into business of the failing concerns; (*d*) geographical or industrial area studied; (*e*) methods of procedure and of analysis used; and (*f*) representativeness of samples employed.

These problems are discussed and limitations suggested as specific evidence is presented.

Of 23 studies made of local experience which include estimates of longevity, 2 [1] cover periods of more than 50 years; the others concentrate upon recent turn-over records.

COMPARISON OF LONGEVITY

To the extent that local studies in scattered communities of the United States represent the general experience, approximately 30 percent of retail firms discontinue business within their first year. An additional 14 percent dissolve before reaching their second anniversary.

A summary, presented in table 1, records the results of three studies presenting certain similarities, but having sufficient variation in content and method to illustrate the need for care in interpretation.

[1] Solon Ayers: A Study of Mortality of Retail Grocery Stores in Austin, Tex., from 1880 to 1932. (Manuscript of University of Texas, Master's Thesis.)

TABLE 1.—*Life span combined retail groups*

[Percent of concerns discontinuing at given age]

Years of life	Poughkeepsie (1844–1933)	Colorado towns (1927–32)	Illinois towns (1926–30)
1	29.6	40.8	27.9
2	14.2	14.3	14.7
3	9.4	6.7	13.1
4	6.2	5.9	3.3
5	4.9	4.3	----------

The Poughkeepsie,[2] N. Y., experience indicates that of concerns entering business at any time within the period 1844–1933, 29.6 percent were not discovered in the directory 1 year later and therefore disappeared as enterprises sometime between the taking of the directory census in which they were listed and the next census. It is possible, of course, that some of these firms may have dissolved in the short period between the census and the publication of the directory. Similarly, other concerns may have entered business immediately after a particular census but received first listing in the directory following the next census, a period exceeding a year.

First-year mortality in 142 towns of Colorado,[3] for retailers entering business in 1927, claimed 40.8 percent of all entrants; that is, 1928 directories did not list almost 41 percent of the retail concerns appearing for the first time in the 1927 issue.

Illinois [4] life-span data cover retail concerns establishing business in 1926 in 2 typical towns, 1 representing a population classification of 7,000 to 15,000 persons, and the other a group, 2,000 to 5,000. In this study the data were obtained from the rating books of R. G. Dun & Co., now Dun & Bradstreet.

The wide variation in the first-year mortality experience of the Colorado towns as compared with the Illinois communities and the town of Poughkeepsie is not associated with business conditions. Both 1927 and 1928 were regarded as good business years in Colorado. In contrast, mortality in the second year, which was 1929, was in close correspondence with the second-year mortality in Illinois, the year 1928, while third-year mortality, 1930, in Colorado was about one-half the third-year discontinuance in Illinois, 1929.

The divergence probably should be charged to some of the difficulties mentioned briefly before. Their importance in invalidating comparison is evident from the following summary:

(*a*) Successive city directories were consulted in the Poughkeepsie and Colorado studies, records of Dun & Bradstreet in the Illinois project. Since the objective in each case was to trace the establishment rather than the proprietor, discrepancies may have occurred with changes in name, form of organization, or address. The Poughkeepsie Directory was not published annually in 7 years, scattered through the period. It is probable that the Dun & Bradstreet records are fairly complete, but the purpose of such records is the providing of credit reports to clients, and some enterprises may escape consideration, particularly the smaller concerns.

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[2] R. G. Hutchinson and A. R. and Mabel Newcomer: Study in Business Mortality, American Economic Review vol. XXVIII, No. 3, September 1938, pp. 497–514.

[3] E. T. Hallas: Mortality of Retail Stores in Colorado, University of Denver Business Study No. 82, 1936, p. 9.

[4] Paul D. Converse: Business Mortality of Illinois Retail Stores from 1925 to 1930, University of Illinois, Bureau of Business Research, Bull. No. 41.

(*b*) As against an aggregate of experience of more than 80 years in Poughkeepsie—each year's entries traced in successive years—only 1 year's entries are considered in Colorado and in Illinois.

(*c*) The Poughkeepsie data cover the city and such adjacent areas as are considered an integral part of the community. One hundred and forty-two towns, excluding Denver, are represented in the Colorado study; and two typical towns, exclusive of Chicago, in the Illinois report.

(*d*) Both Poughkeepsie and Illinois records include all types of independent retail establishments. However, while the former traced the longevity of 10,000 concerns, the latter covers only 61. In the Colorado study, 539 enterprises were included, but only the 10 leading retail trades.

Differences in the elements of other studies are still greater, making comparison even more unwarranted, and emphasizing the neglect of this important field of dynamic economics.

Since the general classification of retail trade includes so many branches of enterprise, it might be assumed that a comparison of individual trades would be simpler. But even the important grocery group is difficult of definition, for though records segregate exclusive meat markets and delicatessens, there still remain groceries with and without meat departments. And drug stores range in activity from the limited-commodity apothecary to the outlet approaching the miscellany of a variety store, and to the establishment with fountain and restaurant service as major merchandising activities.

In table 2 a comparison is offered of the grocery mortality rates in Poughkeepsie, Colorado, and Buffalo,[5] N. Y. Data upon turn-over of new enterprises are not available for Illinois grocers.

TABLE 2.—*Life span of retail grocery stores*

[Percent of concerns discontinuing at given age]

Years of life	Poughkeepsie (1844–1933)	Colorado towns (1927–32)	Buffalo (1919–27)	Years of life	Poughkeepsie (1844–1933)	Colorado towns (1927–32)	Buffalo (1919–27)
1	29.4	27.3	60.3	5	4.2	4.7	1.5
2	14.8	12.5	11.9	6	2.7	2.4	.8
3	10.2	10.2	5.4	7	3.4	6.2	.6
4	6.2	7.0	2.8	8	2.5	.8	.2

In this instance Buffalo experience differs materially in its first year mortality. Within the period, the rate of discontinuance ranged from 54.9 percent in 1921 to 67.8 percent in 1926, the former a depression, the latter a "good business" year. The Buffalo data are from directories, and as in the other cases, an effort was made to trace the continuity of life of establishments rather than of proprietors.

It is possible that the explanation of the heavy mortality within the concerns' first year is associated with the industrial nature of the community. Such information as is available from a Chicago [6] study of combination grocery and meat stores does not support the contention that it is largely industrial status that determines turn-over rate. For the period 1921–32, the average first year discontinuance in Chicago was about 25 percent of entrances. Therefore, assuming that

[5] Edmond D. McGarry: Mortality in Retail Trade; University of Buffalo, Bureau of Business and Social Research, 1930.

[6] Howard C. Greer: Business Mortality Among Retail Meat Stores in Chicago Between 1920 and 1933, Journal of Business, University of Chicago, vol. IX, No. 3, July 1936, pp. 189–209.

methodology and data are comparable, it is logical to conclude that the period was particularly stressful for Buffalo.

In attempting to trace the longevity of drug stores we are limited to reports for Buffalo and the Colorado towns. Again we are dealing with a complicated problem. The Buffalo data cover the discontinuance of establishments entering each year in the period 1919–27, Colorado information covers only the life span of those concerns starting in 1927. However, while the 1919 Buffalo entries, could be followed for 9 years, until 1928, and the 1920 entries for 8 years, the enterprises starting in 1927 could be checked for only the first year of life.

TABLE 3.—*Life span of retail drug stores*

[Percent of concerns discontinuing at given age]

Years of life	Buffalo (1919–27)	Colorado towns (1927–35)	Years of life	Buffalo (1919–27)	Colorado towns (1927–35)
1	26.6	30.8	5	2.5	7.7
2	9.0	23.0	6	3.4	0
3	8.3	7.7	7	2.2	0
4	5.6	0	8	.3	0

Forty-five percent of Buffalo drug stores inaugurating business in 1927, discontinued within a year. This rate should be contrasted with the average Buffalo rate of 26.6 percent recorded in table 3, the extremely low mortality for new Buffalo enterprises entering in 1920—3.1 percent—and the Colorado rate of 30.8 percent. It is probable that this wide range of rates in the Buffalo data is due to the small numbers of drug stores entering each year. And the validity of the Colorado figures for general purposes should be questioned on the same ground; for, though 142 towns were included, only 13 drug stores were established in 1927.

Turn-over of restaurants is relatively high in all available tabulations. For new concerns, however, we are limited to the comparison of rates for Poughkeepsie and Colorado towns. Again it is important to observe that each year's entries are traced in the Poughkeepsie data, but in the Colorado record only those concerns starting in 1927. A total of 170 restaurants were included in the Colorado study, 409 in Poughkeepsie.

It is interesting to note in table 4 the differences in the mortality in the first 2 years. In the long-time experience of Poughkeepsie 48 percent of restaurants discontinued within the first 2 years; in the Colorado period, 71 percent of restaurants entering in 1927 quit by 1929. The differences are in large part compensated by the seventh year, when 84 percent of the Poughkeepsie and 88 percent of the Colorado restaurants had dissolved.

TABLE 4.—*Life span of restaurants*

[Percent of concerns discontinuing at given age]

Years of life	Poughkeepsie (1844–1926)	Colorado towns (1927–35)	Years of life	Poughkeepsie (1844–1926)	Colorado towns (1927–35)
1	35.0	55.5	5	4.6	3.4
2	13.0	15.6	6	4.2	2.3
3	11.0	4.0	7	5.9	2.3
4	8.1	5.3	8	2.4	0

MORTALITY RANK

Were inclusive information available for the country as a whole and for representative areas and communities, a summary of the relative mortality rank of various trades would be helpful to persons planning to establish enterprises in analyzing opportunities and obstacles, to creditors in developing policies, and to business groups and governments in devising plans for aiding stabilization.

As with previous comparisons, there is, unfortunately, no quantitative basis for an accurate rating. But some evidence is available leading to general conclusions.

In three important trades, the order, beginning with the highest first-year mortality, is groceries, drug stores, hardware stores. However, local analyses do not place the turn-over rates of these three as greater than other trades. The order in Poughkeepsie, where drug and hardware records are not separately treated, is confectionery stores, meat markets, cigar stores, and grocery stores. Colorado towns yielded the following store order: Furniture, meat, general, garage, grocery, drug, clothing, hardware, and dry goods. [6]

In table 5, the longevity of retailers in three Minnesota [7] cities is presented as average survivals, first as a turn-over ratio and then as an average life span. The wide differences in rates and age of the "long life" groups as between the Twin Cities and Duluth is striking. In the former, records of approximately 5,500 firms were included, in Duluth, more than 1,000. As a possible explanation, the relatively stationary population, and "changes in the character of trade" in Duluth are suggested. The 5-year turn-over ratio is expressed as "the number of closings—during the 5-year period, 1926–30, per hundred in operation at the end of 1930." "It should be remembered that the death rate here calculated is not an annual rate but covers a 5-year period."

The Minnesota study traced the "firm," or proprietorship, survival, rather than the "establishment" point of view followed by the other reports referred to previously. Rating records and credit files of R. G. Dun & Co. were the basic sources. It is believed that many short-lived enterprises, and "less well-organized types of establishments" were omitted.

TABLE 5.—*Length of life of retail firms in 3 Minnesota cities, 1926–30*

Type	5-year turn-over ratio: Minneapolis and St. Paul	5-year turn-over ratio: Duluth	Average life in years: Minneapolis and St. Paul	Average life in years: Duluth
Short life:				
Building supplies	203.3		2.5	
Stationery and art	183.2	220.0	2.7	2.3
Automobiles	126.7	165.2	3.9	3.0
Electrical	101.2	160.0	4.9	3.1
Novelty	93.4	111.1	5.4	4.5
Food	92.6	131.1	5.4	3.8
Fruit and vegetables	121.9	188.5	4.1	2.6
Groceries	95.5	117.8	5.2	4.2
Clothing and textiles	70.6	94.1	7.1	5.3
Women's clothing	91.8	181.5	5.5	2.8
Long life:				
Lumber	36.5	158.3	13.7	3.2
Jewelry	40.1	93.1	12.4	5.4
Hardware	45.3	75.9	10.8	6.6
Shoes	47.7	75.4	10.5	6.6
Drugs	50.7	63.1	9.9	7.9
Office equipment	51.6	85.8	9.7	5.8

[7] E. A. Heilman: Mortality of Business Firms in Minneapolis, St. Paul, and Duluth, 1926-30. University of Minnesota Press, 1933.

If referring to table 6, a careful distinction must be made, Previous discussion has made use only of those records which disclosed the date of entry into business as well as of the date of closing. In the report of retail survivals in 32 county seat towns,[8] the figures for 1915 and 1935 refer to all concerns then in business regardless of life span. There were 671 grocery stores operating in 1915 and 898 operating in 1935. However, of the latter figure, though an increase of 227 over 1935, only 67 were of the original 671. This 20-year survival, representing 10 percent of grocery and of shoe stores, and 25 percent of drug stores, was only 7 percent of general and department stores, and 4 percent of women's wear stores.

TABLE 6.—*Survival of retail enterprises in 32 county seat towns, 1915 and 1935*

	Grocery stores	General and department stores	Drug stores	Men's clothing stores	Dry goods stores	Hardware stores	Shoe stores	Women's wear stores
1915	671	217	143	128	124	110	88	22
1935	898	118	138	87	55	80	59	73
Survivors	67	16	36	16	15	24	10	1

In Chicago,[9] of the retail food dealers who were liquidating through bankruptcy in 1930–31, 62 percent had failed within 5 years. The same was true for 55 percent of the retail clothing concerns, 80 percent of the grocers, 68 percent of the ladies' ready-to-wear firms, and 44 percent of the men's furnishings stores.

Table 7 records the composite mortality experience for 82 years of certain retail trades in Poughkeepsie. Only those concerns whose entrance year could be determined are included; and the continuance of the establishment rather than of particular proprietors was emphasized. Since specific retail trades were chosen for detailed consideration primarily with reference to their importance in employment as reported by the United States census, drug stores were not included. Moreover, the number of drug establishments are relatively small in a community of this size. Other establishments, such as restaurants, are included among service outlets in table 17. Restaurant mortality in the first 2 years closely corresponds to the experience of meat markets, but survival of the markets is more favorable beginning with the third year. Only 12 percent of the restaurants survived more than 10 years, as contrasted with almost 22 percent of the meat markets.

[8] Dun & Bradstreet: Offered in testimony of Willard L. Thorp and appearing in pt. 1, pp. 129–131, and 235, hearings before the Temporary National Economic Committee, Congress of the United States, 75th Cong.

[9] John H. Cover: Business and Personal Failure and Readjustment in Chicago; Studies in Business Administration, the School of Business, the University of Chicago, August 1933.

TABLE 7.—*Life span of retail enterprises established in Poughkeepsie between 1844 and 1926*

	Grocery stores	Confectionery stores	Meat markets	Cigar stores	All retail stores
Number of enterprises	1,218	325	323	230	4,998
	Percent of concerns discontinuing at given age				
Years of life:					
1	29.4	44.0	35.0	33.5	29.6
2	14.8	16.6	12.7	13.0	14.2
3	10.2	11.7	7.4	10.9	9.4
4	6.0	4.3	5.3	10.4	6.2
5	4.2	4.9	4.6	4.3	4.9
6	2.7	4.6	5.0	6.5	4.1
7	3.4	1.8	2.8	2.2	3.1
8	2.5	2.5	2.5	3.0	2.6
9	2.1	1.2	1.2	.9	2.1
10	2.4	1.3	1.9	1.3	2.0
Over 10	22.3	8.0	21.7	13.9	21.8
Total	100.0	100.0	100.0	100.0	100.0

From the figures of table 8 have been calculated the Colorado entries in the first 4 tables. The cumulative approach of table 8 traces the demise from year to year of the concerns established in 1927 Of the total of 539 retailers starting business in that year 80 percent had succumbed by 1935. One of the obstacles to placing very much credence in the significance of the percentages, is the small number of enterprises represented in some of the trades. Of the 10 categories, 6 had 20 dealers or less. Of 12 hardware stores starting in 1927, 4 survived in 1935, and of 13 drug stores entering in 1927, 4 remained in operation in 1935.

TABLE 8.—*Business mortality of retailers commencing business in 1927 in 142 Colorado towns*

Retail trade	Dealers commencing business in 1927, number	Base year 1927=100 percent	Cumulative percentages of dealers commencing business in 1927 gone in successive years							
			1928	1929	1930	1931	1932	1933	1934	1935
Clothing	20	100	25.0	40.0	50.0	65.0	65.0	65.0	80.0	80.0
Drugs	13	100	30.8	53.8	61.5	61.5	69.2	69.2	69.2	69.2
Dry goods	13	100	23.1	38.5	53.8	53.8	61.5	69.2	76.9	76.9
Furniture	15	100	60.0	80.0	80.0	80.0	80.0	80.0	80.0	80.0
Garages	115	100	34.8	49.6	56.5	62.6	69.6	74.8	79.1	80.9
General stores	20	100	35.0	40.0	45.0	50.0	50.0	60.0	65.0	70.0
Groceries	128	100	27.3	39.8	50.0	57.0	61.7	64.1	70.3	71.1
Hardware	12	100	25.0	33.3	50.0	58.3	66.7	66.7	66.7	66.7
Meat	30	100	60.0	73.3	73.3	80.0	80.0	80.0	83.3	83.3
Restaurants	170	100	55.5	71.1	75.1	80.4	83.8	86.1	88.4	88.4
Total	539	100	40.8	55.1	61.8	67.7	72.0	73.3	79.2	80.0

For contrast with the previous table, table 9 is offered at this point as typical of most available summaries of mortality estimates. In this instance, all retail establishments in the trades indicated were recorded from the 1926 directories. These concerns were then sought in subsequent directories.

It is logical to expect a lower mortality rate for experienced than for new concerns, and evidence that this expectation is realized is presented in subsequent discussion. In addition, the total number of concerns in business is much larger than the number just starting, and the percentage change is necessarily smaller. The total of concerns listed in table 9 is 3,587; of table 8, only 539. The first year rate of mortality based upon all retail establishments in business is 15.7 percent as contrasted with 40.8 percent for new enterprises.

TABLE 9.—*Business mortality of retailers in 142 Colorado towns, 1926–35, classified by 10 retail trades*

Retail trade	Dealers in business in 1926, number	Base year 1926=100 percent	Cumulative percentages of dealers in business in 1926 gone in successive years								
			1927	1928	1929	1930	1931	1932	1933	1934	1935
Clothing	239	100	14.2	23.3	30.5	40.1	46.4	51.9	54.8	61.1	62.3
Drugs	304	100	10.2	18.7	24.0	27.6	34.2	37.2	40.5	45.4	45.7
Dry goods	168	100	8.3	16.7	26.8	36.9	42.9	45.2	50.0	56.6	57.7
Furniture	154	100	9.7	20.1	27.3	33.1	34.4	38.3	41.6	45.4	48.0
Garages	605	100	13.4	29.9	36.5	41.8	46.4	49.8	52.7	57.0	58.8
General stores	302	100	11.9	19.2	25.5	31.1	37.4	39.4	42.4	48.3	60.1
Groceries	997	100	15.2	30.5	40.2	46.3	51.4	54.4	57.5	63.8	65.5
Hardware	188	100	5.3	12.2	18.1	22.9	27.7	31.4	35.1	39.9	41.0
Meat	129	100	20.9	36.4	44.2	55.0	58.9	62.0	63.6	67.4	67.4
Restaurants	501	100	32.3	47.3	56.9	63.5	67.3	70.1	72.8	77.0	77.4
Total	3,587	100	15.7	28.6	36.5	42.8	47.7	50.9	53.9	59.2	60.6

Also based upon all concerns in business rather than new firms is the Illinois [10] summary in table 10, where the combined experience of 255 towns is given for 11 retail groups. The group showing high turn-over rates includes restaurants, garages, grocery, and meat stores; they represented 69.5 percent of the total of 9,718 stores.

TABLE 10.—*Mortality of retailers in 11 trades in 255 Illinois towns*

Retail trade	Dealers in business July 1925		Cumulative percentages of dealers in business in July 1925, gone in July of each year				
	Number	Percentage	1926	1927	1928	1929	1930
Furniture	367	100	8.7	18.5	24.5	30.2	36.2
Grocery	3,646	100	17.5	28.5	38.0	43.8	49.5
Meat	533	100	14.1	25.0	33.2	41.1	46.3
Dry goods	304	100	7.9	15.5	24.0	31.6	35.5
Hardware	442	100	5.2	12.0	17.0	23.8	27.8
Garages	1,595	100	17.2	30.5	39.9	44.8	51.0
Drugs	531	100	7.0	11.3	16.4	20.3	24.3
Department stores	31	100	9.7	19.4	22.6	29.0	38.7
General stores	758	100	14.4	22.8	29.6	35.4	40.5
Clothing	533	100	8.8	17.6	25.7	30.4	36.2
Restaurants	978	100	28.5	44.5	53.7	60.6	64.7
Total	9,718	100	15.9	26.7	35.2	41.0	46.3

The Colorado study did not treat department stores as a separate group. Otherwise 10 trades and services are available for comparison with Illinois results. This is directly facilitated in table 11. The

[10] Paul D. Converse: Business Mortality of Illinois Retail Stores from 1925 to 1930, University of Illinois, Bureau of Business Research, Bulletin No. 41.

principal differences are the sources; the Colorado data were obtained from successive directories, the Illinois material from Dun & Bradstreet rating books. It is probable that the latter records were to a degree incomplete particularly as to small concerns and restaurants, but relatively more complete than had Chicago been included.

Certainly the composite experience of all trades was closely similar in the two States. It is suggested that the dissimilarities in the clothing-store picture is due to the relatively greater number of larger towns in Illinois. The high mortality of these concerns in Colorado may be related to the increased transportation facilities opening to rural population the offerings of the city.

In the high turn-over group in both States are restaurants, meat stores, grocery stores, and garages; the lower exit group includes hardware, furniture, and drug stores.

TABLE 11.—*Business mortality of retailers in Colorado and Illinois*

Retail trade	State	Number	Dealers in business in Colorado in 1926, in Illinois in 1925	Cumulative percentages of dealers in business in base years, gone in successive years				
			1926=100 percent for Colorado 1925=100 percent for Illinois	1 year	2 years	3 years	4 years	5 years
Clothing	Colorado	239	100	14.2	24.3	30.5	40.1	46.4
	Illinois	533	100	8.8	17.6	25.7	30.4	36.2
Drugs	Colorado	304	100	10.2	18.7	24.0	27.6	34.2
	Illinois	531	100	7.0	11.3	16.4	20.3	24.3
Dry goods	Colorado	168	100	8.3	16.7	26.8	36.9	42.9
	Illinois	304	100	7.9	15.5	24.0	31.6	35.5
Furniture	Colorado	154	100	9.7	20.1	27.3	33.1	34.4
	Illinois	367	100	8.7	18.5	24.5	30.2	36.2
Garages	Colorado	605	100	13.4	29.9	36.5	41.8	46.4
	Illinois	1,595	100	17.2	30.5	39.9	44.8	51.0
General stores	Colorado	302	100	11.9	19.2	25.5	31.1	37.4
	Illinois	758	100	14.4	22.8	29.6	35.4	40.5
Groceries	Colorado	997	100	15.2	30.5	40.2	46.3	51.4
	Illinois	3,646	100	17.5	28.5	38.0	43.8	49.5
Hardware	Colorado	188	100	5.3	12.2	18.1	22.9	27.7
	Illinois	442	100	5.2	12.0	17.0	23.8	27.8
Meat	Colorado	129	100	20.9	36.4	44.2	55.0	58.9
	Illinois	533	100	14.1	25.0	33.2	41.1	46.3
Restaurants	Colorado	501	100	32.3	47.3	56.9	63.5	67.3
	Illinois	978	100	28.5	44.5	53.7	60.6	64.7
Total	Colorado	3,587	100	15.7	28.6	36.5	42.8	47.7
	Illinois	9,718	100	15.9	26.7	35.2	41.0	46.3

GROCERY STORE SURVIVALS

In drawing comparisons of cities and trades, life span of grocery outlets has been discussed and data presented in tables 2, and 5 to 10, particularly with respect to information regarding Poughkeepsie and Buffalo, N. Y., and towns of Illinois and Colorado.

Additional contributions to our information regarding survival of grocery establishments include census reports for Buffalo, directory lists for Austin, Tex., a comparison of two periods in Fort Wayne in one of which chain-grocery stores were competitors, and a 4-year record of chain-grocery store turn-over in Boston.

Census tabulations for Buffalo [11] cover the 3 years 1929, 1933, and 1935, and represent the continuance of enterprises under the same ownership and at the same address. Although changes in address are probably infrequent and affect a small proportion, it is a factor to be recognized. In addition, the legal, or ownership, classification is used in this instance, as distinct from the establishment as an entity.

Buffalo independent grocery stores continuing in 1933 represented 47.1 percent of those enumerated for 1929. By 1935 only 28.8 percent of those recorded in 1929 remained. Of the 1933 independent grocers listed, 52.7 percent remained in 1935.

In table 12 are recorded the dates on which listed establishments "came under present ownership." In many instances these firms were originally established under present ownership but in other cases were acquired by present owners in the first year recorded. For instance, as recorded in column two, 7.8 percent of the enterprises reporting in each of the years 1929, 1933, and 1935 came under present management in 1929, whereas almost 10 percent were acquired in 1927 and only about 1 percent have continued under present ownership since 1890. In the third column is recorded the experience of stores reported in 1929 but not subsequently. In contrast to the distribution in column two, it is interesting to note that more than 47 percent of those not reporting subsequent to 1929 came under present ownership between 1927 and 1929. Of the firms represented in column two, about one-fourth had been in business more than 10 years in 1929, and more than one-half had been under present ownership for 6 years.

Infant mortality is illustrated in column three in the percentages of the last 3 years; although some of these firms may have continued in business until just before the 1933 census, the figures still give point to the large proportion of new proprietors who discontinued business.

TABLE 12.—*Percent distribution of 1,169 independent grocery stores according to date of present ownership* [1]—*Buffalo*

Year of present ownership	Three-year identical 1929, 1933, and 1935	Stores recorded in 1929 only	Year of present ownership	Three-year identical 1929, 1933, and 1935	Stores recorded in 1929 only
Before 1890	1.1		1924	8.2	5.0
1890 to 1899	2.6	1.2	1925	7.8	6.0
1900 to 1904	2.4	1.8	1926	5.4	8.6
1905 to 1909	3.7	1.8	1927	9.9	11.2
1910 to 1914	6.7	4.2	1928	7.5	17.3
1915 to 1919	9.1	5.6	1929	7.8	18.9
1920	6.7	5.0	Not included	9	1.8
1921	6.9	2.0			
1922	6.0	4.2	Total	100.2	100.2
1923	7.5	5.6			

[1] This table includes stores identical in ownership and address for the years 1929, 1933, and 1935, together with stores which reported in 1929 only.

[11] Edmond D. McGarry, The Structure and Stability of Retail Trade in Buffalo, 1929, 1933, and 1935—Grocery Stores; Statistical Survey, the University of Buffalo, Bureau of Business and Social Research, Vol. XIV, No. 7A, March 1939.

The source of information for grocery mortality in Austin,[12] Tex., was the local directory. As indicated in table 13, the data were available at 2-year intervals, so that many stores surviving less than 2 years are likely to have been missed if they were established subsequent to the publication of one directory and were discontinued prior to the listing for the next. Stores which closed within the 2-year period are counted as having existed the entire interdirectory period.

Austin grocery store mortality accounted for almost 48 percent of all concerns in business within the first 2 years of their establishment, and of 83 percent within 10 years.

TABLE 13.—*Accumulated percentage of deaths by year periods, grocery stores in Austin, Tex., 1880 to 1932*

Number of years:	*Accumulated percentage of deaths*	Number of years—Continued.	*Accumulated percentage of deaths*
2	47. 7	19	94. 2
4	64. 6	22	94. 9
6	74. 1	24	96. 2
8	79. 3	26	97. 1
10	82. 8	28	98. 0
12	85. 5	29	98. 1
14	89. 6	31	98. 2
16	91. 6	33	98. 8
17	93. 7	35	98. 9

An interesting comparison of individually owned grocery stores in Fort Wayne,[13] Ind., was made for two periods, 1890–1904 and 1916–30. The percentage of firms discontinuing business after a given number of years in existence are presented in table 14.

TABLE 14.—*Mortality of independent grocery stores entering business in Fort Wayne*

Number of years	1916–30 percent closing	1890–1904 percent closing	Number of years	1916–30 percent closing	1890–1904 percent closing
1	40. 3	38. 7	6	1. 4	1. 6
2	12. 1	13. 2	7	. 7	1. 4
3	7. 4	5. 4	8	. 5	1. 8
4	5. 5	4. 8	9	. 3	1. 8
5	3. 0	2. 6			

In the earlier period, 499 grocery stores entered business; in the recent period, 942. Apparently, no important change in the rate of mortality has occurred. This fact is particularly significant, since chain-store competition developed in 1916 with the establishment of the first grocery chain unit in Fort Wayne and increased to a maximum of 73 chain stores in 1928.

In an examination of the Boston[14] Directory for the period, 1928–33, the data of table 15 were revealed for chain-store units in the grocery trade.

[12] Solon Ayers: A Study of Mortality of Retail Grocery Stores in Austin, Tex., from 1880 to 1932 (manuscript of University of Texas, Master's Thesis).

[13] Russell L. Furst: "Relationships Between the Numbers of Chain and Individually Owned Grocery Stores in Fort Wayne," University of Chicago Journal of Business, vol. V, No. 4, pt. I.

[14] Charles F. Phillips: Chain Store Mortality, University of Chicago, Journal of Business, vol. VII, No. 4, October 1934.

TABLE 15.—*Turn-over, closing, and opening rates for chain grocery stores in Boston, 1929–32*

Year	Stores at first of year	Number closed in year	Number added in year	Net change	Number stores in business during year	Turn-over rate, 2 to 5	Closing rate, 2 to 1	Opening rate, 3 to 1	Average number stores during year	Turn-over, 2 to 9
	1	2	3	4	5	6	7	8	9	10
1929	781	107	123	16	904	11.8	13.7	15.7	779.0	13.7
1930	797	86	70	−16	867	9.9	10.8	8.8	789.0	10.9
1931	781	74	62	12	853	8.7	9.5	7.9	775.0	9.5
1932	769	56	49	−7	818	6.8	7.3	6.4	765.5	7.3
Total	3,128	323	304	−19	3,442	9.4	10.3	9.7	3,108.5	10.4

OTHER RETAIL, CRAFT, AND SERVICE GROUPS

The high mortality of restaurants and garages has been mentioned in earlier comparisons. In table 8, 9, 10, and 11 they were included among retail establishments. Additional data are available for Poughkeepsie, covering several service and craft groups, and for Chicago comparing meat stores with combination grocery and meat outlets.

Selecting 3 years as a test period of survival, it is found that Poughkeepsie barber shops established in the period 1844 to 1926 had a record of almost 56 percent survival, exceeded only by express service, with 61 percent. Confectionery stores had a survival of only 28 percent beyond 3 years; grocery stores, 45.6 percent; meat markets, 44.9 percent; cigar stores, 42.6 percent; and restaurants 41 percent, as listed in table 7.

In tables 16 and 17, respectively, are recorded the length of life of craft and of service enterprises in Poughkeepsie. An additional indication of the relative stability of barber shops is the survival beyond 10 years of almost one-third of the concerns.

It will be observed that the basis of calculation is again the total number of stores in business, and that entrance and mortality rates are relative to all, rather than new stores.

Using the record of 1929 as an example, it is apparent that the figure "16," in column 4, is obtained by subtracting the figure "107" in column 2 from the 123 of column 3. Similarly, the total 904, of column 5, is the summation of the 781 of column 1 and the 123 of column 3.

The three mortality rates, then, are as follows: Column 7 records the proportion of the stores existing at the beginning of the year which closed during that year. In column 6 the number of discontinuing concerns is expressed as a ratio of the maximum number existing in the particular year. Taking into account existing, closing, and new enterprises, column 10 presents a ratio of closing establishments to the total stores when the numbers at different periods within the year are averaged.

Comparison of columns 7 and 8 indicates the relative decrease, after the first year, of the chain-store population.

TABLE 16.—*Length of life of specific crafts established in Poughkeepsie between 1844 and 1926, not counting change in proprietorship as a new business*

	Shoemakers	Barbers	Tailors	All crafts
Number of enterprises	331	278	263	1,315
	Percentage distribution			
Years of life:				
1	30.2	25.9	37.3	30.7
2	15.1	10.1	14.5	14.7
3	9.4	8.3	8.7	9.7
4	5.1	7.5	4.9	5.6
5	4.2	5.4	5.7	5.3
6	3.9	3.2	5.3	3.7
7	3.6	1.1	1.1	3.0
8	1.8	2.2	2.3	2.6
9	1.8	2.2	1.1	1.9
10	2.7	1.1	1.9	1.9
Over 10	22.1	33.1	17.1	20.9
Total	100.0	100.0	100.0	100.0

TABLE 17.—*Length of life of specific kinds of service enterprises established in Poughkeepsie between 1844 and 1926, not counting change in proprietorship as a new business*

	Saloons	Restaurants	Express service	All service enterprises
Number of enterprises	641	409	175	2,618
	Percentage distribution			
Years of life:				
1	36.7	35.0	21.1	32.7
2	15.1	13.0	9.7	13.0
3	9.2	11.0	8.6	9.4
4	6.6	8.1	6.3	6.7
5	4.5	4.6	5.7	5.1
6	3.9	4.2	2.3	3.9
7	3.7	5.9	5.7	3.5
8	2.8	2.4	3.4	2.6
9	2.5	1.7	6.3	2.3
10	2.2	2.0	3.4	2.0
Over 10	12.8	12.2	27.4	18.8
Total	100.0	100 0	100.0	100.0

The rates of turn-over of Chicago[15] meat markets and of stores with meat and other commodities are entered in table 18. In each instance the average number of entrances and of discontinuances is expressed as a percentage of the total number of stores in business in that year. A slower rate of turn-over appears in the later years, particularly of combination stores. There is an interesting difference in the rates in the depression years 1921 and 1930.

[15] Howard C. Greer: Business Mortality Among Retail Meat Stores in Chicago Between 1920 and 1933, Journal of Business, University of Chicago, vol. IX, No. 3, July 1936, pp. 189–209.

TABLE 18.—*Rate of turn-over of meat markets and combination stores in Chicago*

[Percent of number in business in given year]

Year ending July 1	Meat markets	Combination stores	All stores	Year ending July 1	Meat markets	Combination stores	All stores
1921	29.6	30.6	30.2	1929	18.1	18.7	18.4
1922	21.0	25.2	23.5	1930	19.8	18.7	19.2
1923	17.6	20.9	19.5	1931	15.4	16.2	15.8
1924	16.5	18.3	17.5	1932	17.4	13.5	15.4
1925	14.7	17.3	16.2	1933	16.0	11.8	13.8
1926	18.9	18.9	18.9				
1927	19.9	19.8	19.8	Average	18.6	19.1	18.9
1928	17.0	18.4	17.7				

In table 19 stores in existence in 1933 are distributed in accordance with their present age. For instance, 18.4 percent of the meat markets in business in 1933 had existed less than 1 year, while only 12.7 percent of the combination stores were such recent entrants into business. However, survival of concerns which had weathered the infant frailties showed little disparity between the two groups.

TABLE 19.—*Percentage distribution of stores in business in Chicago in 1933, according to number of years in business*

Number years in business	Meat markets		Combination stores		All meat markets	
	Simple	Cumulative	Simple	Cumulative	Simple	Cumulative
Less than 1 year	18.4	18.4	12.7	12.7	15.3	15.3
1 to 2 years	12.1	30.5	12.5	25.2	12.3	27.6
2 to 3 years	9.7	40.2	10.9	36.1	10.4	38.0
3 to 4 years	9.5	49.7	10.6	46.7	10.1	48.1
4 to 5 years	7.7	57.4	7.6	54.3	7.7	55.8
5 to 6 years	8.2	65.6	8.1	62.4	8.1	63.9
6 to 7 years	6.1	71.7	6.9	69.3	6.5	70.4
7 to 8 years	4.6	76.3	6.1	75.4	5.4	75.8
8 to 9 years	4.8	81.1	4.6	80.0	4.7	80.5
9 to 10 years	3.0	84.1	3.5	83.5	3.2	83.7
10 to 11 years	3.8	87.9	2.8	86.3	3.2	86.9
11 to 12 years	2.4	90.3	2.6	88.9	2.6	89.5
12 to 13 years	1.7	92.0	1.8	90.7	1.8	91.3
More than 13 years	8.0	100.0	9.3	100.0	8.7	100.0
Average age	5.4 years		5.8 years		5.6 years	

INFANT MORTALITY

In previous illustrations of mortality, the large rate of turn-over in the first, and even in the second, year of business existence was noted. The proportion discontinuing each year may vary by industry, or region, or economic period, but the battle for life is, in general, more difficult in the early years.

Our discussion of factors in business mortality discloses many of the reasons for infant death, in large part related to inadequate nourishment and inexpert nursing. As a result, turn-over is closely associated with rate of entry into business. Or, as expressed by Thorp,[16] mortality is a function of entry. With realization of this relation, and with evidence of the large mortality so soon after initiation of a business, attention can be focused upon devices for reducing the

[16] Willard L. Thorp: "Trend of Failures in the Distribution Field," an address before the Tenth Boston Conference on Distribution; quoted in a release by the Bureau of Foreign and Domestic Commerce, Business Information Section, October 1938.

number of entries. An effort in this direction is made in a separate section.

High first- and second-year mortality rates are evidenced on a comparable basis in tables 7, 16, and 17. The order of first-year turn-over in Poughkeepsie experience, beginning with the highest mortality rate is as follows: Confectionery stores, tailors, saloons (drinking places), restaurants, meat markets, cigar stores, shoemakers, grocery stores, barbers, and express service. As contrasted with 44 percent first-year discontinuances for confectionery stores, express companies lost only 21 percent of their numbers in the first year. It is difficult to estimate to what extent this local rank may represent the composite picture of the United States. It is probable that grocery stores would stand higher on the list. Drug-store mortality, it is recalled, was not analyzed separately for Poughkeepsie.

Probably the most readily available evidence of the trend of infant mortality over a period of years is presented in a record of retail grocery store mortality in Austin, Tex.[17] The source of information was the classified lists of the city directories. Unfortunately the directories were published at 2-year intervals, except for the special editions of 1898, 1910, and 1930, and, therefore, first-year discontinuances cannot be estimated. In addition, it is possible for a store to exist nearly 2 years without appearing in the record. Concerns closing within the 2-year period were counted as having lived the entire interdirectory period.

For the whole period, 1880–1932, there was an apparent declining tendency in the infant mortality of Austin groceries. In the subperiods, 1882–1900, 1901–20, and 1921–32, the mortality rates within the first 2 years of life were 54.2, 48.1, and 41.3 percent, respectively. This ratio of 2-year closures to the numbers of entering business is summarized for directory periods in table 20. The average infant-mortality rate was 47.7 percent. In only three periods did this rate fall below 40 percent, and in each instance this was a depression year: 1914, 1922, and 1929.

TABLE 20.—*Infant mortality as percent of entrances of preceding period, grocery stores, Austin, Tex.*

Period	Infant mortality rate	Period	Infant mortality rate	Period	Infant mortality rate
	Percent		*Percent*		*Percent*
1882 to 1883	58.7	1899 to 1900	50.0	1917 to 1918	50.0
1884 to 1885	72.7	1901 to 1903	42.2	1919 to 1920	53.2
1886 to 1887	41.4	1904 to 1905	56.0	1921 to 1922	37.1
1888 to 1889	61.1	1906 to 1907	45.5	1923 to 1924	47.8
1890 to 1891	51.5	1908 to 1909	52.1	1925 to 1927	47.4
1892 to 1893	45.5	1910	42.6	1928 to 1929	41.4
1894 to 1895	57.2	1911 to 1912	42.8	1930	28.2
1896 to 1897	47.4	1913 to 1914	35.2	1931 to 1932	45.4
1898	59.4	1915 to 1916	60.9		

One significant fact to be derived from table 21 is that, on the average, infant closures make up almost 51 percent of total closures.

[17] Solon Ayers: Op. cit.

TABLE 21.—*Relation of infant mortality to total mortality, by periods from 1882 to 1932, grocery stores, Austin, Tex.*

Period	Total mortality (percent)	Infant mortality (percent)	Infant mortality as percent of total mortality	Period	Total mortality (percent)	Infant mortality (percent)	Infant mortality as percent of total mortality
1882 to 1883	39	27	69	1908 to 1909	69	37	53
1884 to 1885	30	24	80	1910	44	26	59
1886 to 1887	31	24	77	1911 to 1912	51	31	60
1888 to 1889	51	33	64	1913 to 1914	38	19	50
1890 to 1891	32	17	53	1915 to 1916	61	28	46
1892 to 1893	35	15	43	1917 to 1918	59	28	47
1894 to 1895	41	24	58	1919 to 1920	60	33	55
1896 to 1897	32	18	56	1921 to 1922	52	23	44
1898	34	19	56	1923 to 1924	62	33	53
1899 to 1900	27	16	59	1925 to 1927	52	37	48
1901 to 1903	46	19	41	1928 to 1929	63	36	57
1904 to 1905	50	28	56	1930	58	20	34
1906 to 1907	40	23	57	1931 to 1932	60	25	40

In 1931–32 60 percent of all grocery stores discontinued, while one-fourth of the enterprises entering business in 1930 were recorded as closing. The resultant ratio of 40 indicates that turn-over of new stores in that period was only 40 percent as great as for all stores in business. This proportion was the smallest in the 50-year period.

An interesting general picture of the relation of entries to discontinuances for Chicago [18] independent meat stores is obtained from table 22. In 1921 there were fewer entrances than exits, new enterprises accounting for about 24 percent of all stores in business, and discontinuances reaching more than 37 percent of the aggregate. For the 13 years represented, the proportions of new and of retiring concerns were about equal, over 23 percent.

TABLE 22.—*Changes in numbers of individually owned retail meat stores in Chicago*

	Number of entrances	Total number in business in year	Number of closures	Number at end of year	Net increase or decrease	Percent to total	
						Entrances	Closures
Year ending July 1—							
1920				4,818			
1921	1,160	5,978	1,806	4,172	−646	24.1	37.4
1922	1,338	5,510	1,297	4,213	41	32.1	31.0
1923	1,316	5,529	1,078	4,451	238	31.2	25.6
1924	1,417	5,868	1,029	4,839	388	31.8	23.1
1925	1,611	6,450	1,043	5,407	568	33.3	21.5
1926	1,372	6,779	1,280	5,499	92	25.4	23.7
1927	1,386	6,885	1,366	5,519	20	25.2	24.8
1928	1,288	6,807	1,208	5,599	80	23.3	21.9
1929	959	6,558	1,207	5,351	−248	17.1	21.5
1930	944	6,295	1,211	5,084	−267	17.6	22.6
1931	844	5,928	937	4,991	−93	16.6	18.4
1932	817	5,808	892	4,916	−75	16.4	17.9
1933	748	5,664	781	4,883	−33	15.2	15.9
Average	1,169	6,158	1,164	4,994		23.4	23.3

Differences in the first-year mortality of straight meat markets and of those combined with other commodities, usually groceries, are indicated in table 23. Greer suggests that the slight advantage of the combination stores may be due to larger capital investment and superior management, a conclusion supported by other studies of

[18] Howard C. Greer: "Business Mortality Among Retail Meat Stores in Chicago Between 1920 and 1933," Journal of Business, University of Chicago, vol. IX, No. 3, July 1936, pp. 189–209.

survival. However, for the 12-year period, the average rates were similar.

The turn-over rates of tables 22 and 23 should not be confused. In the last column of table 22 discontinuances are expressed as percentages of the total numbers in business at the end of the year, while in table 23 the percentages represent the proportions of new firms closing within their first year.

TABLE 23.—*First-year mortality of retail meat markets, Chicago*

[Discontinuances as percentage of total entries]

Year of entrance [1]	Straight meat markets	Combination stores	Year of entrance [1]	Straight meat markets	Combination stores
1921	31.6	35.3	1928	20.1	19.1
1922	23.6	30.4	1929	23.9	22.8
1923	23.8	27.9	1930	20.2	13.3
1924	21.4	26.4	1931	30.9	22.6
1925	23.1	23.8	1932	31.3	22.3
1926	25.8	24.4			
1927	24.3	26.4	Average	25.0	24.6

[1] Year ending July 1.

In table 24 new meat markets are classified in accordance with the year of their discontinuance. Since the study was completed with the year 1933, mortality of concerns entering in that year was not traced, and the record of those entering in the previous years was brought to a close. Therefore, only the survivors of the 1921 entries could be followed through 12 years.

An interesting feature of the Chicago meat store experience is the large mortality in each of the first 3 years. On an average, one-fourth discontinued within 1 year of establishing in business, and one-fifth during the second year. In most other instances cited the first-year closures were relatively higher and the second-year perhaps one-half as great. In fact the third year average mortality of the meat stores closely approximates the second year turn-over of Poughkeepsie grocery stores, which lost 29.4 percent of their number in the first year.

TABLE 24.—*Chicago retail meat stores entering each year classified according to length of life*

[Percentage discontinuing in each successive year]

Year of entrance [1]	First	Second	Third	Fourth	Fifth	Sixth	Seventh	Eighth	Ninth	Tenth	Eleventh	Twelfth	Remaining
1921	33.9	21.7	12.1	6.6	5.1	3.5	2.5	2.8	1.4	1.2	0.8	0.8	7.5
1922	27.7	21.4	12.6	8.6	6.3	4.1	3.2	2.6	1.9	1.2	1.0		9.3
1923	26.1	18.6	18.1	7.0	4.8	4.4	3.6	3.0	1.6	.8			12.0
1924	24.2	21.2	17.3	7.7	6.6	4.8	3.1	1.6	2.3				11.1
1925	23.4	25.6	14.8	8.0	6.1	3.8	2.5	1.5					14.2
1926	25.0	19.9	15.8	9.0	5.8	2.5	2.7						19.3
1927	25.4	19.7	16.7	6.9	5.0	3.4							22.9
1928	19.6	21.7	14.1	7.5	6.0								31.0
1929	23.3	18.2	12.8	6.6									39.0
1930	16.6	20.3	10.7										52.4
1931	26.8	13.4											59.8
1932	26.7												73.3
Averages:													
Simple	24.9	20.2	14.5	7.5	5.7	3.8	2.9	2.3	1.8	1.1	.9	.8	13.6
Cumulative	24.9	45.1	59.6	67.1	72.8	76.6	79.5	81.8	83.6	84.7	85.6	86.4	100.0

[1] Year ending July 1.

It will be recalled that grocery store turn-over in Buffalo appeared to be unusually high as compared with other communities for which data were available, and that no difinite reason could be found for its unique position. In table 25 the infant mortality record may be constrasted with the data of tables 7, 16, 17, and 24. While the Buffalo[19] experience is high for the first year, the second year discontinuances are relatively not so excessive; however, the closures in subsequent years continue comparable to experience elsewhere, suggesting that grocery stores in Buffalo are on the whole short-lived.

Similar comparisons for Buffalo[19] are offered for drug stores in table 26 and for hardware outlets in table 27. Contrasts are striking. The average rates of discontinuance, within the first year, of new grocery stores is 60 percent, of hardware stores, almost 35 percent, and of drug stores, approximately 27 percent. Of the establishments entering business in 1919, the proportions continuing after 1928, the ninth year, are as follows: Groceries, 5 percent; hardware, 13.1 percent; drug, 28.5 percent. Certainly a prospective proprietor should consider carefully the odds against him before entering the retail grocery field in Buffalo.

TABLE 25.—*Buffalo grocery store entrances each year classified according to length of life*

[Percentage discontinuing in each successive year]

Years of entrance	First	Second	Third	Fourth	Fifth	Sixth	Seventh	Eighth	Ninth	Percentage continuing after—
1919	61.1	14.3	6.2	5.0	2.3	1.9	1.3	0.8	2.1	9 years, 5.0.
1920	55.7	15.2	9.1	4.8	2.7	1.2	2.8	1.9		8 years, 6.6.
1921	54.9	16.7	8.6	4.6	3.0	2.4	2.4			7 years, 7.4.
1922	61.2	14.2	5.1	2.9	4.1	2.4				6 years, 10.1.
1923	58.8	13.0	5.9	5.3	2.8					5 years, 14.2.
1924	61.8	11.9	10.0	3.9						4 years, 12.4.
1925	60.0	16.3	5.2							3 years, 18.5.
1926	67.8	7.0								2 years, 25.2.
1927	57.5									1 year, 42.5.
1919–27	60.3	11.9	5.4	2.8	1.5	.8	.6	.2	.2	Continuing after 1927, 16.3.

TABLE 26.—*Buffalo drug store entrances each year classified according to length of life*

[Percentage discontinuing in each successive year]

Years of entrance	First	Second	Third	Fourth	Fifth	Sixth	Seventh	Eighth	Ninth	Percentage continuing after—
1919	28.5	4.8	9.6	9.5	4.8	9.5	4.8	0	0	9 years, 28.5.
1920	3.1	12.5	6.3	9.4	3.1	6.2	9.4	3.1		8 years, 46.9.
1921	20.8	8.3	12.6	4.2	0	8.3	12.5			7 years, 33.3.
1922	26.0	12.0	14.0	4.0	2.0	10.0				6 years, 32.0.
1923	20.4	8.2	10.2	12.2	10.2					5 years, 38.8.
1924	35.7	2.4	9.6	9.5						4 years, 42.8.
1925	39.0	12.2	9.8							3 years, 39.0.
1926	18.2	18.2								2 years, 63.6.
1927	45.1									1 year, 54.9.
1919–27	26.6	9.0	8.3	5.6	2.5	3.4	2.2	.3	0	Continuing after 1927, 42.1.

[19] Edmund D. McGarry: Mortality in Retail Trade; University of Buffalo, Bureau of Business and Social Research, 1930.

TABLE 27.—*Buffalo hardware store entrances each year classified according to length of life*

[Percentage discontinuing in each successive year]

Years of entrance	First	Second	Third	Fourth	Fifth	Sixth	Seventh	Eighth	Ninth	Percentage continuing after—
1919	47.8	4.3	17.4	4.3	13.1	0	0	0	0	9 years, 13.1.
1920	20.8	20.8	8.3	8.3	0	8.3	0	4.2	-	8 years, 29.3.
1921	42.3	30.7	7.7	3.9	0	0	0	-	-	7 years, 15.4.
1922	21.0	5.3	5.3	5.3	5.3	5.3	-	-	-	6 years, 52.5.
1923	31.7	4.9	12.2	2.4	0	-	-	-	-	5 years. 48.8.
1924	40.7	14.8	7.4	3.7	-	-	-	-	-	4 years, 33.4
1925	52.2	8.7	8.7	-	-	-	-	-	-	3 years, 30.4.
1926	29.4	20.6	-	-	-	-	-	-	-	2 years, 50.0.
1927	25.0	-	-	-	-	-	-	-	-	1 year, 75.0
1919–27	34.5	12.3	7.5	2.9	1.7	1.2	0	.4	0	Continuing after 1927, 39.5.

VARIATIONS WITH TIME

Reference to the fluctuations in numbers of enterprises and to the increase of business population is made in another section. It is important at this point, however, to observe mortality experience in the retail field in relation to changes in business welfare.

But, in order to emphasize that closures are not related solely to depressions, the survival experience of retail establishments in Poughkeepsie [20] was examined for three 30-year periods, an interval far longer than any cycle period.

The period from 1844 to 1873, as observed in table 28, experienced the largest relative mortality in infant years, due, it is thought, to unwarranted commercial expansion following the rapid population growth of the community. As with the growth of industry, distributive enterprise attempts to estimate consumer needs based upon population growth, the increase of purchasing power, and alterations in specific demand. In a competitive system overexpansion is a common experience due to the many individual estimates of the potential aggregate demand, and the optimistic assumptions as to the proportion of the aggregate business which each enterpriser hopes to garner.

TABLE 28.—*Length of life of retail-business enterprises in Poughkeepsie in three 30-year periods, 1844–1933*

[Cumulative percentage distribution]

Years of life	1844–73	1874–1903	1904–33	Years of life	1844–73	1874–1903	1904–33
1 or less	34	27	30	3 or less	60	49	53
2 or less	50	40	44	Over 3	40	51	47

Far more significant as a causal factor in mortality, is the overoptimism of the proprietor regarding the short-run period. With small operating capital, obligations are incurred in all phases of business, from store space to inventory. The impact of a depression, or

[20] R. G. Hutchinson, and A. R. and Mabel Newcomer: "Study in Business Mortality," American Economic Review, vol. XXVIII, No. 3, September 1938, pp. 497–514.

of a fortuitous event, or even of an unusually heavy seasonal decline, find many operators unable to weather the storm.

In turn, the creditor probably has shared the optimism of his customer, and, in addition, perhaps, has extended assistance beyond his conservative judgment as a move to forestall his competitors. In a stringent period, he needs fluid assets and becomes concerned about his debtors; pressure to liquidate obligations results. But in many instances the debtor is unable to respond. Frequently, moreover, the creditor postpones pressure as long as possible with the hope of tiding the debtor over the emergency and of retaining his good will for future business relations. These facts help to explain the lag of closures behind the impact of business recession which is so evident in some of the data presented here.

Bankruptcy records of the Chicago [21] area were studied to trace the experience of firms seeking formal liquidation in 1930. Assuming 1922 as a good year, from a cyclical point of view, to enter business, the intervening period was 8 years. It was found that the following percentages of the cases in retail trade failed prior to their eighth year: Food, 78; clothing, 66; grocers, 86; ladies' ready-to-wear, 73; and men's furnishings, 50. Twenty-two percent of all firms had weathered the 1921 depression, but had succumbed subsequently.

Since liquidation is postponed as long as possible, increases in commercial failure tend to reach maxima after improvement in business is under way. Similarly, the day of reckoning is postponed through dull summers in the hope of compensating autumn and holiday trade. Year-end liquidations occur with a rush. January and December rank high, August and September low, both in numbers of bankruptcies and in liabilities.

Discontinuances of retail groceries in Austin,[22] Tex., from 1880 to 1932, averaged 33 percent of the number of establishments in business. The results by periods, recorded to the tally of city directories, are given in table 29.

TABLE 29.—*Closures during period as percent of stores at beginning of period—Austin*

Period:	Percent of closures	Period—Continued.	Percent of closures
1880–81	53.2	1910	29.6
1882–83	47.0	1911–12	31.1
1884–85	39.0	1913–14	22.8
1886–87	29.5	1915–16	34.9
1888–89	39.8	1917–18	34.7
1890–91	29.1	1919–20	34.7
1892–93	31.5	1921–22	29.7
1894–95	34.7	1923–24	32.3
1896–97	27.8	1925–27	38.0
1898	29.5	1928–29	29.1
1899–1900	23.8	1930	26.0
1901–03	35.1	1931–32	27.6
1904–05	32.0		
1906–07	29.4	Average	33.0
1908–09	41.3		

[21] John H. Cover: Business and Personal Failure and Readjustment in Chicago; Studies in Business Administration, the School of Business, University of Chicago, August 1933.

[22] Solon Ayers: A Study of Mortality of Retail Grocery Store in Austin, Tex., from 1880 to 1932 (manuscript of University of Texas master's thesis).

In commenting upon these fluctuations, Mr. Ayers concludes:

Thus we see that during the decline period of a depression there is a strong tendency for closures to decrease and that during the recovery period of a depression there is a strong tendency for closures to increase. The close connection between depressions and closures is further seen in the fact that six out of the total of nine decreases in closures, 1884, 1897, 1907, 1914, 1922, and 1929, occurred during the decline period of depressions, and that five out of eight increases in closures occurred during recovery period after the depressions of 1893, 1897, 1907, 1914, and 1922. In other words, there are practically no increases or decreases in closures that are not directly connected, chronologically if not causally, with depressions.

The differences in withdrawals in individual years as related to the number of stores in existence is illustrated in table 30, with data from Buffalo.[23]

TABLE 30.—*Turn-over of grocery, drug, hardware, and shoe firms—Buffalo*

[Number withdrawing each year as a percentage of total stores engaged in business during the year]

Year	Percentage withdrawals [1]				Year	Percentage withdrawals			
	Grocery	Drug	Hardware	Shoes		Grocery	Drug	Hardware	Shoes
1918	29.6	6.7	18.5	19.0	1923	38.8	11.8	18.7	30.4
1919	37.0	14.9	17.2	15.3	1924	36.3	14.3	11.4	28.0
1920	32.8	7.2	14.2	22.8	1925	34.9	11.7	18.7	17.7
1921	32.8	14.1	21.2	14.1	1926	42.2	11.6	13.7	20.2
1922	39.1	12.1	16.2	26.3	1927	34.1	19.2	12.9	22.5

[1] The number of firms going out of business each year is stated as a percentage of the total number in business that year.

Following the depression of late 1920 and of 1921, there were high closure rates for grocery stores from 1922 to 1924. The reactions of shoe, drug, and hardware enterprises appeared to be more immediate; drug and hardware outlets show high relative withdrawals in 1921, while shoe-store closures were extensive in 1920 and again from 1922 through 1924.

There appears little similarity in the experience of Pittsburgh[24] and Buffalo for the 3 years which are identical. Possibly the small proportion of Pittsburgh closures following the depression of 1929 is in part accounted for by the selective carry-over from the previous depression and the more conservative policy of creditors.

TABLE 31.—*Mortality of firms in the hardware, shoe, drug, and grocery trades—Pittsburgh*

[Number withdrawing each year as a percentage of total stores engaged in business during the year]

Year	Percentage withdrawals				Year	Percentage withdrawals			
	Hardware	Shoe	Drug	Grocery		Hardware	Shoe	Drug	Grocery
1925	14.6	20.5	9.8	23.6	1930	10.6	18.4	9.4	18.4
1926	12.1	18.4	11.2	22.6	1931	8.0	13.5	6.6	16.7
1927	6.2	11.5	12.9	22.5	1932	5.0	14.1	5.3	17.2
1928	13.3	14.4	11.0	19.4	1933	10.4	14.3	8.7	18.2
1929	12.7	16.3	10.2	21.8	1934	8.1	21.1	9.2	21.3

[23] Edmund D. McGarry: Mortality in Retail Trade; University of Buffalo, Bureau of Business and Social Research, vol. XIV, No. 7A, March 1939.

[24] A. E. Boer: "Mortality Costs in Retail Trades," Journal of Marketing, vol. II, No. 1, July 1937, pp. 52-60.

In table 31 are the mortality rates for each year of the interval for the hardware, shoe, drug, and grocery trades. The figures are computed as percentages of the number actually engaged in business and withdrawing in the year indicated. It required approximately 10 years, 6 years, 11 years, and 5 years to effect a complete turn-over of firms in the hardware, shoe, drug, and grocery trades, respectively. The average ratio of withdrawals are as follows: Hardware, 10.1 percent; shoe, 16.3 percent; drug, 9.4 percent; grocery, 20.2 percent.

The 1919–27 experience of Buffalo[25] grocery stores is summarized in table 25. For the whole period, the average mortality rate for the first year in business was 60.3 percent of entrances, while the range was from 54.9 percent in the depression year, 1921, to 67.8 percent in the "good business" year of 1926. In the last column to the right of the table is an indication of survival after a given number of years. For instance, 42.5 percent of groceries established in 1927 continued business beyond that year; since 57.5 percent closed within the first year, all new establishments are accounted for. An opportunity was available to check for 2 years the enterprises established in 1926; all but 25.2 percent had closed by the end of 1927.

The infant mortality rate of Austin grocery stores decreased sharply during six of the seven depressions in the 50-year period considered, as illustrated by table 32.

TABLE 32.—*Effect of decline period of depressions upon infant mortality—grocery stores, Austin, Tex.*

Decrease in infant mortality rate:	
1892–93	6.0
1896–97	9.8
1906–07	10.5
1913–14	7.6
1921–22	16.1
1928–29	6.0

In the period directly following depressions, however, the infant mortality rate shows a sharp increase in five of the six depressions. The 1929 depression was not included because it was considered as not having closed by 1932, when the Austin report was completed. The increase in rate after depressions is shown in table 33.

TABLE 33.—*Effect of recovery period of depressions upon infant mortality—grocery stores, Austin, Tex.*

Increase in infant mortality rate:	
1894–95	11.7
1898	12.0
1908–09	6.6
1915–16	25.7
1923–24	10.7

Table 34 supports the contention that infant mortality adds momentum to the decline of total mortality in the recovery period following a depression.

TABLE 34.—*Infant closures as percent of total closures during 6 depressions—grocery stores, Austin, Tex.*

Period	Total mortality	Infant mortality	Infant mortality as percent of total mortality	Period	Total mortality	Infant mortality	Infant mortality as percent of total mortality
1884–85	30	24	80	1913–14	38	19	50
1896–97	32	18	56	1921–22	52	23	44
1906–07	40	23	57	1928–29	63	36	57

[25] Edmund D. McGarry: Op. cit.

Closures have little apparent effect upon entrances; but entrances do influence closures. In large part, certainly in the retail field, discontinuances are related to the entry of new establishments, and a period with an increase of new enterprises is likely to be followed immediately by a period of high mortality.

SIZE OF COMMUNITY

Although it is possible that retail establishments in small communities have longer life spans, on the average, than concerns in the same trades in cities, there appears to be no conclusive evidence to verify this contention. As is usual in economic and social problems, so many factors unite in establishing tendencies that it is difficult to dissociate one thread from the composite fabric.

In analyzing the results of his study of discontinuances in 255 Illinois [26] towns, Converse suggests the possible advantage of the small-town merchant, but warns, "A part of this difference, however, may be due to the difference of definition used in this study." The city of Chicago was not included.

Similarly, while tendencies in the aggregate may suggest an advantage to smaller communities in Colorado,[27] Hallas comments: "It is doubtful, however, that the finding of this study will adequately support any generalizations concerning mortality of retail stores in small towns as compared with that obtaining in the larger towns and cities." As in the Illinois study, the Colorado analysis did not include the largest city, Denver.

As evidence of the absence of convincing data, comparisons are offered in table 35. In each trade, the smallest first-year mortality is placed at the top, and the higher rates follow progressively. If the studies were strictly comparable and the size of community were the controlling factor, the order in each instance should place Colorado first and Illinois second. It is apparent that the low Illinois relatives for drug and hardware stores have little connection with size of community.

TABLE 35.—*Variations in first year mortality*

	Percent of concerns closing		Percent of concerns closing
Retail grocery:		Retail hardware:	
Illinois	17.5	Illinois	5.2
Fort Wayne	21.6	Buffalo	16.3
Louisville	25.0	Colorado	25.0
Colorado	27.3	Restaurants:	
Buffalo	36.0	Illinois	28.5
Retail drug:		Kansas City	50.0
Illinois	7.0	Colorado	55.5
Buffalo	12.6		
Chicago	15.5		
Colorado	30.8		

For further discrepancies, tabulations of closures by size of community are presented for Colorado in table 36, and for Illinois in table 37. They are not directly comparable; it is difficult to correlate the population groups. But it is apparent that the Illinois study has a larger proportion of large communities than the Colorado

[26] Paul D. Converse, "Business Mortality of Illinois Retail Stores from 1925 to 1930," University of Illinois, Bureau of Business Research, Bull. No. 41.

[27] E. T. Hallas, "Mortality of Retail Stores in Colorado," University of Denver Business Study No. 82, 1936, p. 9.

study. While 19 percent of the Colorado communities have populations of 2,000, 31 percent of the Illinois towns are in this group. Of establishments, Colorado has 60 percent of the total in towns exceeding 2,000 of population, Illinois, 82 percent.

Limiting our attention to a comparison within each State, again there are conflicting results. A slight advantage might appear to rest with smaller towns in Colorado, but the mid-group, 1,000 to 2,000, has the lowest first-year mortality. In contrast, the cities of Illinois seem to show an advantage over the towns, but not significantly.

Among the items reducing the plausibility of a definite advantage is one purely mechanical in nature—the use of rates with small numbers. For example, in the 100 Illinois towns with population under 400, only 2 clothing stores existed in July 1925. One store, or 50 percent, discontinued in 1927. The second closed in 1928, recording a 100-percent mortality within 3 years. Although this calculation is mathematically correct, its influence upon the total estimate is spurious, and resulting comparisons are unsound.

TABLE 36.—*Business mortality of retailers in 10 trades in 142 Colorado towns, 1926–35, classified by size of towns*

Size of town	Number of towns	Dealers in business in 1926		Cumulative percentage of dealers in business in 1926 gone in successive years								
		Number	Base year 1926=100 percent	1927	1928	1929	1930	1931	1932	1933	1934	1935
Under 500	43	334	100	12.9	21.3	33.5	42.8	46.1	49.7	53.2	57.5	62.3
500 and under 1,000	43	533	100	16.5	31.7	33.8	40.3	40.9	48.2	52.3	58.3	59.5
1,000 and under 2,000	29	594	100	11.4	26.1	34.0	41.4	47.8	50.7	53.0	56.7	58.8
2,000 and under 5,000	12	450	100	15.8	29.3	36.2	42.4	48.7	52.0	55.1	62.2	63.6
5,000 and over	15	1,676	100	17.5	30.8	38.9	44.8	48.8	51.9	54.6	59.9	61.6
Total	142	3,587	100	15.7	28.6	36.5	42.8	47.7	50.9	53.9	59.2	60.6

TABLE 37.—*Turn-over or mortality of retail stores in 11 trades in 255 Illinois towns, arranged according to size of towns, July 1925 to July 1930*

Size of town	Number of towns studied in each group	Dealers in business July 1925		Cumulative percentages of dealers in business in July 1925 gone in July of each year				
		Number	Percent	1926	1927	1928	1929	1930
Under 400	100	619	100	17.8	30.7	36.8	42.6	47.2
400 to 1,000	75	1,059	100	17.2	25.4	35.3	41.5	46.8
2,000 to 5,000	50	2,120	100	15.6	27.2	32.8	39.7	44.9
7,000 to 15,000	25	3,111	100	16.5	26.9	36.9	43.5	49.3
Over 35,000	5	2,809	100	14.5	25.7	34.6	38.7	43.7
Total	255	9,718	100	15.9	26.7	35.2	41.0	46.3

Problems and obstacles involved in the comparison of various studies as recorded in the introductory treatment of retail-store mortality apply to the data of table 35. The illusion resulting from percentage comparisons has just been cited. Brief mention of other differences is appropriate.

The percentages refer to the proportions of concerns discontinuing to all establishments of that trade in business at the particular time. This made it necessary to exclude Poughkeepsie relatives which refer to the proportions of new firms closing. Sources of data are of importance. The Colorado records were based upon directory lists; Illinois information was obtained from the files of Dun & Bradstreet. Colorado and Illinois figures represent the composite experience of towns within each State, excluding in each instance the largest city, while only individual cities were covered in the other studies. In addition, there are variations in periods of time, classifications of trades, geographical areas, and in industrial concentrations.

LIFE SPAN AND NET WORTH

A general impression prevails that the larger concern has a distinct advantage over the smaller in surviving business vicissitudes. Accurate measurement of this relationship is impossible. Corporation reports are available, and commercial ratings for the larger establishments, but information regarding capital investments in small concerns is fugitive and fortuitous.

The significance of capital as a factor in survival is discussed in the section of this report on Factors in Business Mortality, where evidence is presented that not alone do the large enterprises appear to have an advantage in survival, but, in addition, that small concerns do not, in general, grow into large organizations.

An approach to an estimate of capital investment is the net worth of firms based upon credit ratings. In compiling the information for table 38, the data for Minneapolis,[23] St. Paul, and Duluth were obtained from the rating books of R. G. Dun & Co. for 1930. It is obvious that not alone are retail concerns attempting to operate with small capital, but that business enterprises of all kinds are preponderantly small in Minnesota. As disclosed in the last column, almost two-thirds have net worth of less than $2,000, or are unclassified. An additional bias factor is the inclusion in individual proprietorships and partnerships of private properties; an effort has been made to correct this bias in ratings exceeding $5,000.

TABLE 38.—*Number of retail firms in 3 Minnesota cities, classified by net worth, 1930*

Net worth	Number of retailers	Percentage of retail firms	Percentage of all business firms in given group
$500,000 and over	42	0.5	1.6
$75,000 to $500,000	177	2.1	4.3
$10,000 to $75,000	872	10.7	13.1
$2,000 to $10,000	1,587	19.4	15.8
Less than $2,000 or unclassified	5,497	67.3	65.2
Total	8,175	100.0	100.0

The turn-over ratios of retail firms in the Minnesota communities were computed for the period 1926–30. The figures in table 39 represent the number of closing concerns in the 5-year period expressed as

[23] E. A. Heilman: Mortality of Business Firms in Minneapolis, St. Paul, and Duluth, 1926-30 University of Minnesota Press, 1933.

percentages of the total number in business in 1930. The next to the last figure, for instance, indicates that for every 100 retailers in business in 1930 with net worth of less than $2,000, 105 had closed during the 5 years.

Although the small numbers of firms represented in the higher net worth groups do not warrant reliance upon the percentages calculated for these classifications, it is probable that the general picture is significant.

TABLE 39.—*5-year turn-over ratios [1] of retail firms in 3 Minnesota cities, classified by net worth, 1926–30*

Net worth	Number of retailers closing as percent of number in business in 1930	Number of retailers in business, 1930	Number of retailers closing, 1926–30
$500,000 and over	7.1	42	3
$75,000 to $500,000	18.1	177	32
$10,000 to $75,000	25.0	872	218
$2,000 to $10,000	55.0	1,587	871
Less than $2,000 or unclassified	105.0	5,497	5 773
Average	84.4		
Total		8,175	6,897

[1] Ratio of the number closed in the 5-year period to the number in business in 1930.

More directly comparable, since only one kind of retail outlet is included, is the life span of Chicago [29] failing meat stores, classified by the amount of initial investment. Table 40 is constructed to indicate the apparent relation of life span to the capital investment at the time of starting business. All concerns had failed in business.

While no rating was available for more than one-fifth of the concerns, of those with known capital rating at organization, 48.5 percent had less than $1,000. In general, stores with more capital showed greater stamina than those with lesser investment; 43 percent of those with more than $10,000 survived more than 5 years as contrasted with only about 18 percent of those with less than $500. Age in years is recorded in the final column, with a gradually reduced longevity from almost 6 years on an average for the top capital group to less than 3 for the lowest investment category.

TABLE 40.—*Life span of Chicago meat stores, classified by net worth, 1920*

Initial capital rating in thousands of dollars	Percentage of total in each group, 1920	Percentage in business in 1920 continuing more than 5 years	Average length of life, stores in business in 1920	Initial capital rating in thousands of dollars	Percentage of total in each group, 1920	Percentage in business in 1920 continuing more than 5 years	Average length of life, stores in business in 1920
Above 10	3.8	43.4	5.9	½ to 1	12.7	26.6	3.7
5 to 10	4.1	33.7	4.8	Under ½	35.8	17.8	2.7
3 to 5	6.7	32.3	4.5	No rating	21.6	23.4	3.5
2 to 3	6.0	28.7	4.3	All stores	100.0	24.6	3.6
1 to 2	9.3	30.9	4.2				

[29] Howard C. Greer: Business Mortality among Retail Meat Stores in Chicago Between 1920 and 1933, Journal of Business, University of Chicago, vol. IX, No. 3, July 1936.

LIFE SPAN AND SALES

A census study of independent retail grocers in Buffalo [30] yields evidence that it is the larger store which tends to survive, not that older stores necessarily grow, but that smaller stores are eliminated.

The analysis did not indicate significant differences as related to length of ownership in the extent to which sales declined or losses were recovered during cyclical fluctuations. A comparison of the average sales of grocery stores is made in table 41. The years in which the store was founded or acquired by the recording owners is given in the first column. In the second column, the average sales are reported for the concerns which continued under identical ownership and at the same address through the 3 years of census inquiry. In the third column are the sales figures for establishments reporting in 1929 and 1933 but not in 1935; and in the next column are the sales averages for stores reporting only in 1929.

In discussing the data of table 41, McGarry comments as follows:

> The right hand column of this table containing the total stores recorded in each age group clearly indicates that in general the longer the present owner has been operating the store, the greater the sales tend to be. The stores which were operated by the present owner before 1910 had the largest sales per store, while those which had been under present ownership only since 1925 had the smallest. This tendency for the older stores to have greater sales is evident in all three groups under consideration, although there are wider variations in the average size of store from year to year among the group which reported in 1929 only than in either the 2- or the 3-year identicals. The stores which survived and were reported in 1929, 1933, and 1935 were in general larger (except among the oldest groups) than the 2-year identicals, and the 2-year identicals were in turn larger than those which reported only in 1929.

TABLE 41.—*Sales per independent grocery store in 1929 according to years of ownership* [1]*—Buffalo*

Year of present ownership	Stores identical in 1929, 1933, 1935	Stores identical in 1929, 1933	Stores reporting in 1929 only	Total stores recorded
Before 1890	$21,568	$68,921	------------	$39,325
1890 to 1899	25,576	51,257	------------	27,731
1900 to 1904	16,696		$15,042	
1905 to 1909	24,600	27,831	17,794	23,145
1910 to 1914	15,615	29,404	14,113	17,887
1915 to 1919	18,249	8,544	11,015	14,288
1920	21,472	24,379	27,537	24,264
1921	19,623	18,025	8,467	17,567
1922	19,875	16,932	9,800	15,770
1923	22,119	16,301	9,048	16,309
1924	19,090	17,220	11,290	16,230
1925	19,665	12,006	7,645	13,863
1926	15,707	17,996	11,747	13,972
1927	18,182	10,848	12,445	14,592
1928	17,922	14,782	8,066	11,369
1929	11,026	17,153	7,424	9,203

[1] Tables 41 and 42 include stores identical in ownership and address for the years 1929, 1933, and 1935, and the years 1929 and 1933, together with stores which reported in 1929 only.

[30] Edmond D. McGarry: The Structure and Stability of Retail Trade in Buffalo, 1929, 1933, and 1935—Grocery Stores; Statistical Survey, University of Buffalo, Bureau of Business and Social Research, vol. XIV, No. 7A, March 1939.

Since sales values quoted in table 41 are for the year 1929, the various columns are directly comparable. However, with the rapid decline of prices from 1929 to 1933, direct comparisons of sales for these 2 years are not feasible; decline in the dollar value of sales of stores would be expected irrespective of size. The shift into lower brackets is pictured in table 42.

TABLE 42.—*Number of independent grocery stores, percent of total stores, and percent of total sales by size of business 1929, 1933, and 1935—Buffalo*

Stores with sales of—	Number of stores			Percent of total stores			Percent of total sales		
	1929	1933	1935	1929	1933	1935	1929	1933	1935
$0 to $4,999	396	624	715	24.6	43.1	43.0	4.5	9.7	8.6
$5,000 to $9,999	363	344	365	22.6	23.7	23.7	10.1	16.8	14.9
$10,000 to $14,999	248	190	204	15.4	13.1	13.1	11.8	15.6	14.0
$15,000 to $19,999	228	107	137	14.2	7.4	7.4	15.2	12.6	13.1
$20,000 to $24,999	113	69	91	7.0	4.8	4.8	9.7	10.4	11.3
$25,000 to $29,999	68	38	56	4.2	2.6	2.6	7.1	7.1	8.5
$30,000 to $34,999	52	18	25	3.2	1.2	1.2	6.5	4.0	4.5
$35,000 to $39,999	38	20	18	2.4	1.4	1.4	5.5	5.1	3.8
$40,000 to $44,999	27	9	12	1.7	.6	.6	4.4	2.6	2.8
$45,000 to $49,999	10	3	13	.6	.2	.2	1.8	1.0	3.5
$50,000 to $59,999	29	10	4	1.8	.7	.7	6.1	3.7	1.2
$60,000 to $69,999	13	1	7	.8	.1	.1	3.3	6.2	8.3
$70,000 to $99,999	13	10	12	.8	.6	.6	4.0		
$100,000 and over	11	6	5	.7	.4	.4	10.0	5.3	5.6
Total	1,609	1,449	1,664	100.0	100.0	100.0	100.0	100.0	100.0

McGarry analyzes the data as follows:

Slightly less than half of the stores reporting in 1929 had sales of less than $10,000, but by 1933 two-thirds of the stores had fallen into this group. At the same time the percentages of stores in all brackets above $10,000 had declined, the number of stores with sales of over $50,000 declining from 4.1 percent of the total to 1.8 percent. No significant change took place in the percentage of stores in these groups between 1933 and 1935.

Although the number of stores, 66, with sales of over $50,000 in 1929 constituted less than 5 percent of the total, they accounted for 23.4 percent of the independent sales of that year. In 1933 the number of stores in this bracket had been reduced to less than half (27) and they accounted for only 15.2 percent of the total sales. These sales figures are almost exactly reversed for stores with sales of less than $10,000. This classification, which in 1929 (759 stores) accounted for 14.6 percent of total sales, in 1933 (968 stores) accounted for 26.5 percent of the sales. The percentage of total sales in all brackets above $30,000 declined between 1929 and 1933, but the process was largely reversed between 1933 and 1935, so that most of these brackets had gains.

The shift of business toward lower brackets between 1929 and 1933 was obviously due in large part to declines in prices, so that a store might well have supplied the same amount of goods and yet have fallen into a lower bracket. At the same time it must be recalled that a larger proportion of the total grocery business was being done by chain stores, so that on the whole independents were losing in physical volume as well as in dollar sales.

In the United States as a whole for the year 1933, 64 percent of all retail stores recorded sales not exceeding $10,000; this group accounted for 13.8 percent of total retail sales for the country. The average per capita sales were valued at $204.[31]

Changes in sales value are illustrated in table 43, in which sales of identical stores are traced from 1929 to 1933 and 1935.

[31] Wm. H. Meserole: Small-Scale Retailing, U. S. Department of Commerce. Bureau of Foreign and Domestic Commerce, Domestic Commerce Series No. 100, 1938.

TABLE 43.—*Sales of independent grocery stores identical in address, 1929, 1933, and 1935, as a percentage of 1929 sales, by size of business in 1929—Buffalo*

Stores with sales of—	Number of stores represented	Sales volume compared with 1929 as 100 percent		Stores with sales of—	Number of stores represented	Sales volume compared with 1929 as 100 percent	
		1933	1935			1933	1935
$0 to $4,999	102	92.9	92.1	$40,000 to $44,999	17	54.3	66.5
$5,000 to $9,999	137	66.3	84.0	$45,000 to $49,999	4	53.1	63.9
$10,000 to $14,999	108	49.3	51.1	$50,000 to $54,999	11	55.6	63.2
$15,000 to $19,999	108	57.1	62.8	$55,000 to $59,999	9	58.8	57.4
$20,000 to $24,999	60	51.7	58.5	$60,000 to $99,999	10	80.9	69.4
$25,000 to $29,999	38	64.3	63.4	$100,000 and over	4	44.4	31.5
$30,000 to $34,999	31	61.5	63.3				
$35,000 to $39,999	17	75.3	73.6	Total	656	60.3	62.5

The average sales volume of 1933 for identical stores was 60.3 percent of the 1929 value; the 1935 average had increased only to 62.5 percent.

In discussing these relatives, McGarry says:

A comparison of the change in sales of stores between 1933 and 1935 indicates that in general those size groups which fell the lowest in 1933 made the greatest come-back in 1935. In other words the more drastic changes at the bottom of the depression were ameliorated. In spite of these changes in extremes, however, most groups maintained their same relative positions as in 1933. Thus stores with less than $10,000 sales continued with a high percent of their 1929 sales, while stores with 1929 sales of between $10,000 and $25,000, although increasing their sales materially, still reported a smaller proportion of 1929 sales than most other groups. Stores in groups between $25,000 and $45,000 maintained higher than average proportion of their 1929 records. Unlike the situation in 1933, stores in groups between $45,000 and $55,000 reached higher than average proportions of their 1929 sales.

The relatively high ratio of 1933 sales for stores in size groups of less than $10,000 may be explained by the fact that these were a highly selected group, since of the total stores included in these two groups in 1929, only 25.8 percent and 37.7 percent reported in the two later census years. The drastic decline in sales of such small stores evidently caused many of them to cease operations. Thus the small stores which were able to continue under these adverse conditions were in general those which maintained a relatively high percentage of their 1929 sales.

It is significant that a larger proportion of stores with sales between $25,000 and $45,000 continued in operation throughout the period than of most other groups. The fact that this group of stores also maintained high sales records throughout the period indicates that they have greater stability than those which are smaller or than those which are very large. A possible explanation for this is that stores of this size are located in trading subcenters and have been gaining ground at the expense of the smaller stores which are more prevalently isolated in residential districts, and the very large stores which are located in the downtown district. This would follow the theory that, with increased price advertising, housewives have tended to shop for their groceries in nearby subcenters having a number of stores rather than making their purchases in isolated neighborhood stores or in the larger stores downtown.

Since sales data of Poughkeepsie [32] concerns were not available, average gross sales in 1935 for the United States were adopted as indicative of size, as in tables 44 and 45. In addition, average numbers of employees for the United States are used in table 44.

The advantage of size appears in the data of table 45, and, with the exception of service establishments—express and barber—in table 45. The roughness of the measure employed does not permit a comparison of commodity and service enterprises.

[32] R. G. Hutchinson and A. R. and Mabel Newcomer: "Study in Business Mortality," American Economic Review, vol. XXVIII, No. 3, September 1938, pp. 497–514.

TABLE 44.—*Comparison of size and longevity of different types of enterprise—Poughkeepsie*

Type of enterprise	Average gross sales 1935, United States total [1]	Average number of employees 1935, United States total [1]	Proportion of Poughkeepsie concerns surviving more than 3 years, 1844–1927
Wholesale	$242,160	7.3	56.3
Retail	24,970	2.7	45.0
Service	6,939	1.7	43.2

[1] Data from U. S. Department of Commerce, Census of Business, 1935.

TABLE 45.—*Comparison of size and longevity of different kinds of business—Poughkeepsie*

Kind of business	Average gross sales 1935, United States total [1]	Proportion of Poughkeepsie concerns surviving more than 3 years, 1844–1927	Kind of business	Average gross sales 1935, United States total [1]	Proportion of Poughkeepsie concerns surviving more than 3 years, 1844–1927
Grocery store	$17,876	45.6	Saloon [2]	$7,346	39.0
Meat market	17,360	44.9	Confectionery store	5,663	27.7
Restaurant	12,793	41.0	Express service	4,468	60.6
Cigar store	11,805	42.6	Barber shop	1,728	55.7

[1] Data from U. S. Department of Commerce, Census of Business, 1935.
[2] "Drinking places" in 1935 census.

POPULATION PER STORE

Since data are not available permitting a study of the relation of success to the actual number of customers patronizing each establishment, general population figures have been used. It is estimated that the average patronage per retail store in the United States in 1933 was 80.4 persons.[33]

The population figures used for the Poughkeepsie [34] estimates are for the city and four satellite towns. It was assumed that increases between census years were in equal amounts each year. The number of persons per retail establishment in Poughkeepsie varied as follows: 1843, 96; 1873, 78; 1903, 97; 1933, 72.

The authors of the Poughkeepsie study feel that the life span is related to local changes in population growth; that "rapid increases in population stimulate a too rapid growth of business enterprises and that a relatively stable population discourages new business." This conclusion is related, of course, to the choice of periods, and while general application is limited by the rapid changes within the merchandising field, such as the development of chain stores and super markets. Also, it is apparent that there is no necessary relation between population per store and the actual patronage of a particular store.

[33] William H. Meserole: Small-Scale Retailing, U. S. Department of Commerce, Bureau of Foreign and Domestic Commerce, Domestic Commerce Series No. 100, 1938.
[34] R. G. Hutchinson and A. R. and Mabel Newcomer: Op. cit.

In Buffalo [35] the population per grocery store for the entire city for 1929 averaged 292. The range for census tracts, small areas selected by the census for enumeration purposes, was from 148 to 2,929; in the latter area, there was only 1 store; in the former, 44 stores. Thirty tracts had ratios of less than 300 persons to a store, while 9 tracts had more than 500. A circumstance affecting the direct comparability is the difference in nature of patronage, some outlets drawing from a widely dispersed clientele though located in a shopping center with small resident population. In 3 areas without shopping centers and with small population per store, the consumer incomes were low; tracts with large population per store were high-income centers.

Changes in the number of persons per grocery store in Austin [36] from 1879 to 1932 are given in table 46. Although fluctuations occur as the number of stores is temporarily decreased, the trend has been definitely toward a larger per-store population. An important limitation of this statement is the absence of information regarding the trade territory covered. Since the population data relate to the city directory, there is available no evidence of the extent of patronage beyond city limits, as transportation, delivery, and mail facilities improved, or as enterprises were established in adjacent areas to compete with city suppliers.

TABLE 46.—*Comparison of population [1] with stores in existence—Austin, Tex.*

Year	Population	Number of stores	Number of persons per store	Year	Population	Number of stores	Number of persons per store
1879	7,263	79	92	1907	28,123	167	168
1881	8,409	83	101	1909	29,273	149	196
1883	10,500	77	136	1910	30,791	164	187
1885	13,698	105	131	1912	33,566	166	202
1887	16,101	128	127	1914	35,000	175	227
1889	14,888	110	135	1916	45,747	170	269
1891	17,004	111	153	1918	46,990	173	272
1893	19,368	118	164	1920	47,409	175	271
1895	19,819	115	172	1922	49,565	192	258
1897	19,687	115	171	1924	55,728	208	268
1898	20,970	113	186	1927	58,755	216	272
1900	21,736	131	166	1929	55,000	224	245
1903	23,861	135	177	1930	53,118	217	245
1905	27,800	136	204	1932	58,697	235	250

[1] Population figures are taken from the city directories.

Meat stores per thousand of population are recorded for Chicago [37] in table 47. The variation seems to occur with changes in business conditions, declining with depressions. Preceding estimates were in terms of persons per store, whereas table 47 records stores per 1,000 persons. In this table, then, the figures would become larger with an increase in the number of stores. Between 1929 and 1933, chain-store units increased steadily relative to population, while independent stores declined. The final column shows the steady increase in the proportion of chain units to total retail meat stores.

[35] Edmond D. McGarry: "The Structure and Stability of Retail Trade in Buffalo, 1929, 1933, and 1935."
[36] Solon Ayers: A Study of Mortality of Retail Grocery Stores in Austin, Tex., from 1880 to 1932.
[37] Howard C. Greer: "Business Mortality Among Retail Meat Stores in Chicago Between 1920 and 1933," Journal of Business, University of Chicago, vol. IX, No. 3, July 1936.

TABLE 47.—*Numbers of Chicago retail meat stores, by type of operation*

[Figures in totals and per thousand of population]

Year (July 1)	Individually owned stores		Chain-store units [1]		All retail meat stores		Percentage chain units to total stores
	Total number	Per thousand population	Total number	Per thousand population	Total number	Per thousand population	
1920	4,818	1.78					
1921	4,172	1.47					
1922	4,213	1.45					
1923	4,451	1.50					
1924	4,839	1.59					
1925	5,407	1.75					
1926	5,499	1.74					
1927	5,519	1.71					
1928	5,599	1.70					
1929	5,351	1.59	220	0.07	5,571	1.66	3.9
1930	5,084	1.51	320	.09	5,404	1.60	5.9
1931	4,991	1.46	340	.10	5,331	1.56	6.4
1932	4,916	1.43	390	.11	5,306	1.54	7.4
1933	4,883	1.40	460	.13	5,343	1.53	8.6

[1] Data on chain-store units partly estimated; not available for years prior to 1929.

A record of the number of retail stores per 1,000 of population in 1926 and 1935 for Colorado [38] towns is given in table 48.

Store densities were less in 1935 than in 1926 for clothing, drug, dry goods, furniture, hardware, meat, and general stores. While grocery stores remained fairly constant, garages and restaurants increased relative to population in all towns. The number of independent retail meat stores per 1,000 persons would appear to be smaller in Colorado towns than in the city of Chicago. It is possible that meat departments of grocery and general stores compensate.

In our discussion of the general opinion that chances of survival were greater in smaller communities, we indicated the lack of evidence. It would appear from table 48 that the number of stores related to population may be greater in the smaller towns; or in other words, that the population per store is less in the smaller towns. To the extent that total available patronage is a factor in survival, this fact would not support the contention mentioned above.

Converse [39] found a close direct relationship between changes in population and changes in the number of retail dealers in comparing the 2 years 1925 and 1930. The average number of stores related to population of 154 towns is presented in table 49. It is necessary, in comparing Illinois rates with those of Colorado and Chicago, to move the decimal points in table 49 one digit to the left, since the population unit is 10,000 persons, not 1,000, as in tables 47 and 48.

In both 1925 and 1930 the Chicago meat-store population rate was more than three times the ratio of the Illinois largest population grouping.

Ignoring the difference in years, the only directly comparable population groups in table 48 and 49 are the towns with from 2,000 to 5,000 inhabitants. But in this group several rates appear to be out of line with other tendencies. For instance, the grocery rates are lower for Colorado in this population group than in any of the

[38] E. T. Hallas: "Mortality of Retail Stores in Colorado," University of Denver Business Study No. 82, 1936, p. 9.

[39] Paul D. Converse, Business Mortality of Illinois Retail Stores from 1925 to 1930, University of Illinois, Bureau of Business Research, Bull. No. 41.

lower or higher population classifications. It is probable that a mechanical element is present here affecting rates, perhaps the small number of towns, and of stores represented.

TABLE 48.—*Number of retailers in 10 trades in 142 Colorado towns per 1,000 population, 1926 and 1935, according to size of towns*

Year	Clothing	Drugs	Dry goods	Furniture	Garages	General store	Groceries	Hardware	Meat	Restaurants
GROUP I. 43 TOWNS WITH POPULATION UNDER 500										
1926	0.4	2.4	1.1	0.4	4.2	4.9	4.1	1.6	1.0	2.8
1935	.1	2.4	.7	.3	4.6	3.4	4.1	1.0	.6	3.6
GROUP II. 43 TOWNS WITH POPULATION OF 500 TO 1,000										
1926	0.7	1.8	0.7	0.5	4.0	3.2	3.2	1.4	0.7	2.3
1935	.3	1.8	.8	.3	4.4	2.3	3.7	1.1	.4	3.3
GROUP III. 29 TOWNS WITH POPULATION OF 1,000 TO 2,000										
1926	0.9	1.4	0.8	0.7	3.2	1.7	3.1	1.1	0.7	2.2
1935	.6	1.3	.8	.3	3.6	1.1	3.4	1.1	.5	3.5
GROUP IV. 12 TOWNS WITH POPULATION OF 2,000 TO 5,000										
1926	0.8	1.0	0.9	0.5	2.7	0.5	2.7	0.7	0.6	1.4
1935	.5	.9	.7	.5	2.9	.3	2.8	.7	.4	3.0
GROUP V. 15 TOWNS WITH POPULATION OF 5,000 AND OVER										
1926	0.7	0.7	0.4	0.4	1.9	0.2	3.7	0.3	0.3	1.3
1935	.5	.6	.2	.4	1.8	.1	3.5	.3	.2	2.1
ALL TOWNS										
1926	0.7	1.0	0.6	0.5	2.5	0.9	3.5	0.6	0.4	1.6
1935	.4	.9	.4	.4	2.5	.6	3.5	.5	.3	2.6

TABLE 49.—*Average number of retail stores for each 10,000 people in 1925 and 1930 for 11 retail trades in 154 Illinois towns*

Trades	Averages, all towns		Town groups							
			400 to 1,000 [1] population		2,000 to 5,000 population		7,000 to 15,000 population		Over 35,000 population	
	1925	1930	1925	1930	1925	1930	1925	1930	1925	1930
Grocery	43.3	37.3	33.1	31.2	38.8	31.5	47.7	38.8	43.5	39.9
Garages	17.7	17.3	40.5	41.9	22.4	23.8	18.2	16.1	11.2	11.4
Restaurants	11.2	12.8	23.0	24.4	12.7	14.1	10.1	10.6	9.4	12.2
Clothing	6.5	5.3	5.5	5.2	7.8	6.5	7.2	5.4	5.3	4.5
General stores	6.4	4.8	41.6	34.4	8.6	6.6	4.8	3.4	.8	.7
Drugs	6.2	6.0	14.3	12.6	7.6	7.3	5.6	5.3	4.7	5.0
Meat	6.1	4.7	12.2	8.6	6.9	5.3	5.1	3.6	5.7	4.9
Hardware	4.7	4.3	17.3	16.0	7.4	7.0	3.5	2.9	2.4	2.3
Furniture	4.4	4.1	7.2	7.0	5.6	5.3	4.5	4.1	3.1	3.2
Dry goods	3.7	3.0	4.8	3.2	7.7	6.4	3.7	3.0	1.4	1.2
Department stores	.4	.4	.2	.0	.3	.3	.6	.6	.3	.3
Total	110.6	100.0	199.7	184.5	125.8	114.1	111.0	93.8	87.8	85.6

[1] Population data for 1 town were not obtainable.

The number of stores per 1,000 of population in the 30 towns studied by the Federal Trade Commission [40] in 1931 average 9.8. The average for independent stores was 7.9, for chain units, 1.9. Farmington, Maine, had the highest independent ratio, 12.7, although 11 of the 30 towns had ratios of 10 or greater. Cullman, Ala., had the highest chain ratio, 3.6; the only other town exceeding a chain ratio of 3 was Albemarle, N. C.

The potential patronage per grocery store in Fort Wayne,[41] Ind., for two periods, 1915–30, and 1889–1904, is listed in table 50. The population figures are for census years, 1889, 1899, 1919, and 1929, with intervening years estimated on an assumption of regular increase each year. Since the number of persons per store is recorded here, table 50 is directly comparable with table 46. In the early period Fort Wayne stores had more than twice the per capita of the Austin grocers, but the difference narrowed in the later period.

TABLE 50.—*Number of inhabitants of Fort Wayne in proportion to the number of retail grocery stores each year, 1915–30 and 1889–1904*

Average number of persons per store:		Average number of persons per store—Continued.	
1915	376	1889	283
1916	391	1890	289
1917	387	1891	263
1918	380	1892	262
1919	399	1893	249
1920	359	1894	268
1921	466	1895	263
1922	374	1896	279
1923	367	1897	284
1924	327	1898	300
1925	342	1899	307
1926	334	1900	309
1927	337	1901	309
1928	350	1902	330
1929	358	1903	347
1930	347	1904	355
Average	368	Average	294

Variations in trades covered, years recorded, community population classifications used, and sources of estimates make a serious effort at comparison futile. It is possible that the average number of persons per store is greater currently than a few generations ago, and perhaps the number per store is greater in large than in small communities. It is well known that the population rate is different for different kinds of stores. It is evident that the reduction in the number of stores following a depression will automatically increase the population per store. However, in all these spotty items there is no evidence that life span has altered as a result of a change of population rate.

FORM OF ORGANIZATION

Since a very small proportion of retail enterprises are corporations, it is of little profit to compare life spans in terms of the form of organization. On the other hand, the large proportion of total business acquired by chain organizations in a number of cities, and

[40] Federal Trade Commission, Chain Stores: The Chain Store in the Small Town. S. Doc. 93, 73d Cong., 1934.

[41] Russell L. Furst: "Relationships Between the Numbers of Chain and Individually Owned Grocery Stores in Fort Wayne," University of Chicago Journal of Business, vol. V, No. 4, pt. I.

particularly in the drug, grocery, and tobacco fields, offers a future opportunity for a detailed analysis of competition. As indicated in our section on factors in business mortality, there is frequent fluctuation in the number of chain units opened and closed, related largely to business conditions but currently perhaps even more directly to the development of a new competitive device, the supermarket. In the latter case, discontinuance of a unit is in reality a form of expansion through merger, and not a formal discontinuance.

The form of organization for Poughkeepsie [42] retail establishments was recorded for 6,230 concerns. The relative unimportance of the corporation in this community is apparent in the following summary: The individual proprietorships constituted 77.2 percent of the total; partnerships accounted for 11.4 percent; corporations, 2.8 percent; and all other forms, 8.6 percent.

Longevity was estimated for 4,998 Poughkeepsie retail concerns. Only 117 of these concerns were incorporated; recognizing the limitations of the small number involved for the whole period, 1844–1927, the comparison of table 51 is still of interest. The apparent advantage of the corporation may be due to a stronger capital position, to more adequate management, and to advantages in purchasing and merchandising.

TABLE 51.—*Comparison of length of life of corporations and all forms of retail enterprises, Poughkeepsie, 1844–1927*

CUMULATIVE PERCENTAGE DISTRIBUTION

Years of life	All concerns	Corporations	Years of life	All concerns	Corporations
1 or less	30	20	8 or less	74	66
2 or less	44	32	9 or less	76	68
3 or less	53	44	10 or less	78	69
4 or less	59	52	Over 10	22	31
5 or less	64	58			
6 or less	68	63	Number of cases	4,998	117
7 or less	72	65			

LIFE EXPECTANCY

Based upon survival experience, several estimates have been made of the probability of continuance in business beyond a given number of years.

In table 52, life expectancy for four retail trades is given, based upon Pittsburgh [43] experience for a 10-year period. Of every 100 drug firms having opportunity for survival in the second year in business, 69 successfully continued. In the hardware field 72 of each 100 survived; in the grocery field, only 53.

In general, the life expectancy increases with the age of the enterprise, heavy mortality occurring in early years. Throughout the survival period, the expectancy for grocery stores is lower than for the other groups.

A similar record for Buffalo [44] for the period 1920–28 is summarized in table 53. Only 40 of each 100 grocers continued in the second year, as compared with 53 in Pittsburgh; of course, the difference in

[42] R. G. Hutchinson and A. R. and Mabel Newcomer: "Study in Business Mortality," American Economic Review, vol. XXVIII, No. 3, September 1938, pp. 497–514.
[43] A. E. Boer: "Mortality Costs in Retail Trades," Journal Marketing, vol. II, No. 1, July 1937, pp. 52–60.
[44] Edmond D. McGarry: Mortality in Retail Trade, University of Buffalo, 1930.

the period studied must be considered, the Pittsburgh data covering 1925 to 1933.

TABLE 52.—*Life expectancy in Pittsburgh, 1925–33*

	Years									
	1	2	3	4	5	6	7	8	9	10
Grocery	100	53	42	34	30	26	23	21	19	17
Drug	100	69	63	60	55	48	43	38	32	30
Hardware	100	72	56	50	44	42	39	39	31	21
Shoe	100	61	50	45	39	38	35	27	27	21

TABLE 53.—*Life expectancy in Buffalo,*[1] *1920–28*

	Years									
	1	2	3	4	5	6	7	8	9	10
Grocery	100	40.0	26.2	19.3	15.1	12.7	10.2	7.9	6.9	5.0
Drug	100	73.4	65.4	55.2	50.0	47.1	41.7	38.9	[2] 39.6	[2] 28.6
Hardware	100	65.5	50.7	41.0	38.1	36.1	27.2	20.5	[2] 21.3	[2] 13.0
Shoes	100	56.2	42.2	32.6	25.8	23.2	19.1	17.5	[2] 20.5	[2] 21.1

[1] In computing the percentages the numbers of firms which had opportunities of surviving for various numbers of years are taken as denominators, and the numbers of firms which did survive for the various lengths of time in question are taken as the numerators. As an example of the method employed, take the computation for the 9-year length of life, for which the grocery-store figure shown in table 53 is 6.9 percent. In 1919, 519 new firms entered the grocery business; 9 years later, or in 1927, 37 of these 519 firms were still in business. In 1920, 515 new firms entered the grocery business; 9 years later, or in 1928, 34 of these were still listed. The entrants during these 2 years of the 11-year period being studied are the only stores included in our count which could have lasted for 9 years. The total number of entrants for these 2 years is 519 firms plus 515 firms, or 1,034 firms. The number of these entrants which remained in business by 1927 or 1928 is 71, or 6.9 percent of 1,034.

[2] Only a small number of stores is included in the count for these years; hence the instability of the figures given.

Based upon the survival experience summarized in table 53, in table 54 there have been formulated the probabilities of continued existence.

It is evident that the first year in the life of any type of store is the most precarious. A change in the probability of life in accordance with the age of the store may be computed. For instance, of 100 stores entering the grocery business in any year, 40 may be expected to continue a second year. Twenty-six of these forty, or about 65 percent, will probably be listed a third year, and of the 26, about 19, or 73 percent, a fourth year. Table 54 represents not the actual life expectancy but rather the change in life expectancy with each additional year's life.

The increase in "additional year expectancy" between the first and second year is greater in the case of grocery stores than for any other type of store studied (from 40.0 to 65.5 percent).

Of the same nature is the material from the Austin [45] study as given in table 55, covering retail grocery stores. Fifty-two percent of the concerns listed continued into their second year.

[45] Solon Ayers: A Study of Mortality of Retail Grocery Stores in Austin, Tex., from 1880 to 1932 (University of Texas, master's thesis).

TABLE 54.—*Probability of a store's remaining in business an additional year beyond any given age—Buffalo, 1920–28*

	Given age—years						
	1	2	3	4	5	6	7
Grocery	40.0	65.5	73.7	78.2	84.1	80.3	77.4
Drug	73.0	89.1	84.4	90.6	94.2	88.5	93.3
Hardware	65.5	77.4	80.9	92.9	94.7	75.3	75.4
Shoes	56.0	75.1	77.2	79.1	89.9	82.3	91.6

TABLE 55.—*Life expectancy in Austin—Survivals out of 1,368 retail grocery stores*

Number of years:	
2	715
4	465
6	322
8	239
10	179
12	147
14	98
16	74
17	52
19	45
22	37
24	26
26	18
28	11
29	10
31	9
33	5
35	4

In table 56 the calculated "chances" of continued existence are recorded for Austin grocers. Based upon the experience of the period, 1880–1932, the probability of continuing a given number of years, knowing present age, is given as related percentages. For instance, at organization, or age zero, the chances of continuing in business for 2 years is 52.3 out of a hundred, or 52.3 percent. At age 2 years, the chances of continuing 2 more years, or until the age of 4, is 67.9 percent; this may be contrasted with the probability of 4 years of life at organization, which is only 35.4 out of a hundred.

TABLE 56.—*Life expectancy, retail grocery stores in Austin, Tex.*

Age attained	Age to be expected, on an average																	
	2	4	6	8	10	12	14	16	17	19	22	24	26	28	29	31	33	35
0	52.3	35.4	25.9	20.7	17.2	14.6	10.4	8.4	6.3	5.8	5.1	3.8	2.9	2.0	2.0	2.0	1.2	1.1
2	-----	67.9	50.8	41.0	27.1	24.1	21.0	16.9	12.7	11.5	10.4	7.9	6.1	4.1	4.1	4.0	2.3	2.1
4	-----	-----	75.8	60.5	50.7	41.9	30.3	24.9	18.8	17.0	15.5	12.9	9.2	7.4	6.8	6.7	4.2	3.9
6	-----	-----	-----	79.4	66.8	55.3	40.3	32.3	21.1	20.9	20.1	15.7	12.9	8.5	8.4	7.6	4.9	3.9
8	-----	-----	-----	-----	83.7	69.3	50.0	48.0	36.9	27.1	24.3	18.8	14.8	10.4	10.1	10.0	6.3	5.3
10	-----	-----	-----	-----	-----	82.1	59.8	48.4	39.4	32.8	29.3	22.6	17.3	11.7	11.5	11.4	7.1	6.0
12	-----	-----	-----	-----	-----	-----	73.1	59.7	44.8	40.9	35.9	27.7	21.1	14.5	14.3	14.1	6.3	8.6
14	-----	-----	-----	-----	-----	-----	-----	81.2	62.7	57.7	50.7	38.3	29.0	20.0	19.2	18.8	11.1	9.5
16	-----	-----	-----	-----	-----	-----	-----	-----	78.8	71.4	61.7	48.5	37.5	26.2	24.5	24.3	14.3	12.5
17	-----	-----	-----	-----	-----	-----	-----	-----	-----	90.0	78.7	60.5	60.0	32.4	30.3	30.0	17.3	14.3
19	-----	-----	-----	-----	-----	-----	-----	-----	-----	-----	88.1	69.2	51.4	35.5	33.3	33.3	19.2	16.2
22	-----	-----	-----	-----	-----	-----	-----	-----	-----	-----	-----	76.5	60.0	42.3	37.9	37.5	21.7	18.2
24	-----	-----	-----	-----	-----	-----	-----	-----	-----	-----	-----	-----	77.3	57.8	53.1	47.6	27.1	23.1
26	-----	-----	-----	-----	-----	-----	-----	-----	-----	-----	-----	-----	-----	73.3	66.6	60.0	35.7	30.8
28	-----	-----	-----	-----	-----	-----	-----	-----	-----	-----	-----	-----	-----	-----	90.0	81.8	50.0	40.0
29	-----	-----	-----	-----	-----	-----	-----	-----	-----	-----	-----	-----	-----	-----	-----	90.0	55.5	44.4
31	-----	-----	-----	-----	-----	-----	-----	-----	-----	-----	-----	-----	-----	-----	-----	-----	62.5	50.0
33	-----	-----	-----	-----	-----	-----	-----	-----	-----	-----	-----	-----	-----	-----	-----	-----	-----	80.0

The number of additional years of life to be expected, on an average, for independent retail meat stores in Chicago,[46] is 5 at the time of entry into business. With survival through 5 years accomplished, an average expectancy of 7.4 additional years is indicated by table 57.

TABLE 57.—*Life expectancy of individually owned Chicago retail meat stores (computed according to their experience between 1920 and 1933)*

Age attained	Percentage of total number continuing for number of years indicated			Average life expectancy of stores of ages indicated (years)
	Meat markets	Combination stores	All meat stores	
Less than 1 year	100.0	100.0	100.0	5.0
1 year	75.5	74.8	75.1	5.5
2 years	55.7	53.8	54.6	6.1
3 years	40.4	38.9	39.6	6.9
4 years	31.6	30.5	30.9	7.2
5 years	25.5	23.7	24.5	7.4

Added to the many differences inherent in the various studies, such as sources and nature of the data, calculation of probability follows somewhat different methods.

From the available information covering grocery stores, however, it may be estimated that the stores (combination) of Chicago displayed the greatest average stamina, followed in order by Pittsburgh, Austin, and Buffalo.

The drug and shoe stores of Buffalo appear to have an advantage in longevity over those of Pittsburgh, a relation which is reversed in the case of hardware outlets.

Were comprehensive and current information of this type adequately available for scientific analysis, the foresighted prospective proprietor and the cautious creditor would be greatly aided in determining zones of safety.

46 Howard C. Greer: "Business Mortality Among Retail Meat Stores in Chicago Between 1920 and 1933," Journal of Business, University of Chicago, vol. IX, No. 3, July 1936.

CHAPTER III

BUSINESS MORTALITY IN MANUFACTURING

Analysis of the life span of manufacturing concerns is complicated by the formal aspects of their organization and the efforts made for rehabilitation of insolvent concerns.

Individual proprietorships and partnerships are typical of the retail field, the corporation more especially of manufacture. When a proprietor fails, his establishment usually closes; a partnership is readily dissolved. But a corporation commonly has diverse and scattered ownership; its liabilities affect extensive interests; its place in industry, usually related to size, has economic and social implications of wide ramification.

A corporation in financial difficulties passes into receivership which is a legal process devised to conserve the interests of owners, creditors, and the public, through the appointment of a manager responsible to the court. The object is basically to reorganize and to reestablish solvency. After months or years the corporation may be dissolved; but the problem of determining life span is then complex. Shall the date of establishing receivership control be accepted, or the date of final liquidation?

Revision of our bankruptcy laws has placed emphasis upon rehabilitation rather than upon liquidation, further enlarging the advantage of the corporate form.

LONGEVITY

In the experience of more than 70 years, only 53 percent of Poughkeepsie [1] manufacturing establishments continued in existence more than 3 years. City directory lists were consulted in following the longevity of concerns, as described in the discussion of retail mortality.

Two circumstances are important in considering the special problem of the corporate form. In a community the size of Poughkeepsie, the proprietorship and partnership forms of organization would be represented relatively more frequently than in the larger cities. In addition, as a device recent in popularity the corporate form would appear infrequently in the early part of the period represented, 1844–1926.

These facts make the comparisons of table 58 particularly interesting. In the second column, the ownership point of view is stressed, the "firm" rather than the establishment, in contradistinction to the third column in which the plant or store is the unit. While the longevity of 945 establishments was traced without regard to proprietorship, 1,194 concerns were involved when proprietorship was considered.

[1] R. G. Hutchinson and A. R. and Mabel Newcomer: "Study in Business Mortality." American Economic Review.

262652—41—No. 17——5

TABLE 58.—*Length of life of manufacturing enterprises in Poughkeepsie between 1844 and 1926*

	Changes in proprietorship counted	Changes in proprietorship not counted
Numbers of enterprises	1,194	945
	Percentage distribution by years of life	
Years of life:		
1	24.0	23.1
2	13.1	11.5
3	12.7	12.3
4	8.0	7.8
Years of life—Continued.		
5	5.4	5.5
6	4.5	5.3
7	2.7	2.3
8	2.9	2.4
9	2.7	2.4
10	2.7	2.0
Over 10	21.4	25.3
Total	100.0	100.0

The principal difference as the result of the double classification is the longevity beyond 10 years, where there is an advantage of the establishment over the person. Had the corporate form of organization been important in this picture we should have expected even a closer agreement as to numbers and years of life in the two columns.

Between the years 1844 and 1916 there were 846 Poughkeepsie manufacturing concerns established which subsequent to 1916 were liquidated. Of this number, 107, or 12.6 percent, continued in business more than 20 years. In table 59 the mortality of manufacturing concerns is approximated. Two-thirds of the enterprises failed to continue beyond their sixth year, and three-fourths did not reach their eleventh year.

TABLE 59.—*Length of life of manufacturing enterprises in Poughkeepsie between 1844 and 1926*

Years of life	*Cumulative percent of firms*
1 or less	23
2 or less	35
3 or less	47
4 or less	55
5 or less	60
6 or less	66
7 or less	68
8 or less	70
9 or less	73
10 or less	75
Over 10	25

In a study of mortality in Minneapolis, St. Paul, and Duluth, Minn., from 1926 to 1930,[2] the average age of manufacturing firms upon discontinuance was 8 years. The average life of printing establishments was 62.6 years, an unusual record. Woodworking establishments averaged 15.5 years, and lumber manufacturers 11.4 years. The range of other manufacturing groups was from 7.7 years for the food industry, and 6.7 years for leather and shoe firms, to 4.9 years for clothing and textiles, and 2.6 years for music and radio.

In the field of shoe manufacture, a sample area,[3] including the States of Maine, Pennsylvania, Wisconsin, and Missouri, and the cities of Lynn, Haverhill, Brockton, and Rochester, disclosed an average life up to 1935 of 5.2 years for firms starting in business since 1905. This

[2] E. A. Heilman: Mortality of Business Firms in Minneapolis, St. Paul and Duluth, 1926–1930. University of Minnesota Press, 1933.

[3] Horace B. Davis: "Business Mortality: The Shoe Manufacturing Industry." Harvard Business Review, spring 1939.

analysis counted a concern as discontinuing if succeeded by another firm.

Automobile manufacturers [4] of the United States had an average life span of 8 years from the date of their entry until 1924. For the 181 automobile manufacturers [5] in business in the period, 1903 to 1926, the average longevity was 9.4 years.

SHIFTS WITH TIME

As in the classification of retail establishments, the Poughkeepsie [6] life span of manufacturing enterprises was divided into three 30-year periods, as in table 60. It is apparent that survival has increased relatively in the most recent period. Only 22 percent of manufacturing establishments discontinued within 1 year during the years 1904 to 1933, as compared with 24 percent and 25 percent, respectively, in the two earlier periods. Survival beyond 3 years was greater relatively, as well. These rates are based upon the experience of new concerns, not of all concerns in business.

In each year since 1923, the mortality rate of shoe-manufacturing [7] concerns has exceeded 10 percent, and in the period 1926–34 it was above 16 percent of all firms in business. For the period, 1905 through 1935, the average rate was 12.4 percent; this was a loss each year of one firm in eight. In commenting upon this record, Davis concludes, "Neither the mortality nor the insolvency of the shoe firms seems to be greatly affected by the business cycle."

In addition, the size of operations of firms, as a whole, showed decreases in their period of existence. Of 1,296 firms, 819 failed to grow.

A discussion of general trends and cycles of failures appears in a separate section.

TABLE 60.—*Length of life of business enterprises in Poughkeepsie in 3 periods, 1844–1933*

Years of life	Cumulative percentage distribution			Years of life	Cumulative percentage distribution		
	1844–73	1874–1903	1904–33		1844–73	1874–1903	1904–33
1 or less	25	24	22	3 or less	48	50	44
2 or less	38	38	33	Over 3	52	50	56

SIZE OF COMMUNITY

As pointed out in the treatment of retail-store mortality, there is a dearth of significant information relating life span to the size of community, and there should be a corresponding skepticism as to the importance of this single factor.

However, a study of the shoe-manufacturing industry [8] developed interesting conclusions which are directly opposed to the usual assump-

[4] Ralph C. Epstein: "The Rise and Fall of Firms in the Automobile Industry." Harvard Business Review 2, January 1927.
[5] Ralph C. Epstein: The Automobile Industry: Its Economic and Commercial Development. McGraw-Hill, Inc., 1928.
[6] R. G. Hutchinson and A. R. and Mabel Newcomer: Op cit.
[7] Horace B. Davis: Op. cit.
[8] Horace B. Davis: Op. cit.

tions regarding the advantages of small towns. Davis is quoted as follows: "As between the small towns and the larger, it is significant that the mortality is higher in the former. Our study covered completely four States which contain a considerable number of shoe firms in different localities, and in each of which one city stands out as larger and more important than the others, both in size and in the number of shoe plants. The States, with the corresponding shoe metropolis in each, were Maine (Auburn-Lewiston), Pennsylvania (Philadelphia), Wisconsin (Milwaukee), and Missouri (St. Louis). The shoe firms in the smaller towns had a mortality of 90 percent from 1885 to 1911 and of 83 percent from 1911 to 1937, while the four larger cities showed a mortality of only 87 percent and 79 percent respectively in the 2 periods. This finding tends to confirm the view, already held by students of the industry, that the better-managed firms prefer the superior facilities of the medium and larger cities while the firms (other than branches of large firms) that gravitate to the smaller towns in search of lower costs tend to be less capable; they usually go out of business anyway."

LIFE SPAN AND NET WORTH

Based upon credit ratings, table 61 classifies Minnesota [9] manufacturing enterprises recorded in 1930. Approximately 50 percent had an estimated net worth of $2,000 or less or were unclassified. This pecuniary weakness indicates the "shoestring" character of many enterprises. Moreover, to the extent that these firms are proprietorships or partnerships, there is an upward bias in the estimates of concerns of less than $5,000, since private assets are included in the credit ratings of these firms.

For the period, 1926–30, 1,225 manufacturing firms closed, as classified in table 62. In this period, the number of closing manufacturing firms approximated 62 percent of the total number in business in the last year of the period. With the exception of the second net-worth group, the lower the capital investment, the greater the mortality rate.

TABLE 61.—*Number of manufacturing firms in 3 Minnesota cities classified by net worth, 1930*

Net worth:	*Number*
$500,000 and over	97
$75,000 to $500,000	226
$10,000 to $75,000	425
$2,000 to $10,000	225
Less than $2,000 or unclassified	1,001
Total	1,974

TABLE 62.—*Number of manufacturing firms closed in 3 Minnesota cities classified by net worth, 1926–30*

Net worth	Number closed	Number closed in period as percent of 1930 total
$500,000 and over	16	16.5
$75,000 to $500,000	34	15.0
$10,000 to $75,000	152	35.8
$2,000 to $10,000	149	66.3
Less than $2,000 or unclassified	874	87.4
Total	1,225	62.0

[9] R. A. Heilman: Op. cit.

FORM OF ORGANIZATION

Aside from a dynamic study of changes in form of organization, reported in a later comparison, the most significant summary of relationships, particularly as regards life span, was reported for Poughkeepsie.[10]

The proportionate distribution of the 1,095 manufacturing concerns opening and closing in the period 1844–1927 is given in table 63. With almost 52 percent individual proprietorships and less than 14 percent corporations, it might be expected that other factors, such as size and nature of business, would determine the differences. Or it is possible that Poughkeepsie corporations, as elsewhere, are usually larger than proprietorships and partnerships.

Table 64 discloses longevity advantage associated with corporations over the total of manufacturing establishments, including corporations, for the first 6 years of life. With the seventh year the balance shifts. The 6-year advantage is so short that it might even be associated with complex legal procedures, such as receivership, rather than with economic merits.

TABLE 63.—*Form of organization, Poughkeepsie manufacturing enterprises*

Type:	*Percentage distribution*
Individual enterprise	51. 7
Partnership	22. 2
Corporation	13. 7
All others	12. 4
Total	100. 0

TABLE 64.—*Length of life of corporations compared with all forms of Poughkeepsie manufacturing concerns, 1844–1927*

Years of life	Cumulative percentage: All concerns	Cumulative percentage: Corporations	Years of life	Cumulative percentage: All concerns	Cumulative percentage: Corporations
1 or less	23	10	8 or less	70	73
2 or less	35	26	9 or less	73	75
3 or less	47	40	10 or less	75	76
4 or less	55	48	Over 10	25	24
5 or less	60	55	Number of cases	945	108
6 or less	66	63	Percent incorporated		11. 4
7 or less	68	69			

[10] R. G. Hutchinson and A. R. and Mabel Newcomer; op. cit.

CHAPTER IV

COMPARISON OF MORTALITY EXPERIENCE OF VARIOUS TYPES OF BUSINESS

Steps in the production and distribution of goods and services differ so widely as to structure and function, that a comparison of life spans for manufacturing, wholesaling, and retailing might appear anomalous. And yet we have found within both the retail and the manufacturing fields great differences in longevity, suggesting that even these classifications are not necessarily fundamental lines of demarcation in the problem of mortality.

LONGEVITY

Little attention of a detailed nature has been given to the wholesale field. As a group, wholesale concerns appear to withstand the impact of destructive elements better than retailers as a whole; but the experience of Poughkeepsie [1] wholesale establishments for the period 1844–1927 indicates, as in table 65, that only 31 percent continued in operation more than 10 years.

TABLE 65.—*Length of life of wholesale enterprises in Poughkeepsie, 1844–1927*

Years of life:	*Cumulative percent of firms*	Years of life:	*Cumulative percent of firms*
1 or less	20	7 or less	62
2 or less	29	8 or less	65
3 or less	38	9 or less	68
4 or less	46	10 or less	69
5 or less	51	Over 10	31
6 or less	56		

The maximum average age of Minneapolis and St. Paul [2] wholesalers, 30 years, was enjoyed by the printing and paper industry. This was less than half that of the leader in the manufacturing field. This period was closely approximated by electrical equipment firms with an average of 28.4 years. The average for leather and shoe establishments was 24.1 years; for agricultural machinery, 19 years; for meat wholesalers, 15 years; and for wholesale jewelers, 14.6 years. No other group averaged half the life span of the jewelers, food wholesalers reaching 7 years, and lumber and woodworking, 6 years. Music and radio and clothing and textiles enterprises barely exceeded 5 years, while cigars and tobacco and oil approximated 4 years, and construction machinery 3 years, on an average.

Interesting comparisons of Minnesota records for the cities of Minneapolis, St. Paul, and Duluth are contained in tables 66, 67, and 68.

[1] R. G. Hutchinson and A. R. and Mabel Newcomer; op. cit.
[2] E. A. Heilman; op. cit.

Reference to table 66 suggests a similarity in the staying qualities of manufacturers and wholesalers, with heavy odds against retail concerns. As the table footnote indicates, the figure, 84.4 percent, for retailers means that more than 8 retail firms failed in the period, 1926–30, for every 10 establishments in business in 1930.

Longevity, on an average, for retailers was even less than for service groups, according to table 67. The average length of life for all enterprises in the three cities was 6.6 years. It will be recalled that the rating records of Dun & Bradstreet were the sources of the Minnesota data and represent the firm, or ownership unit, rather than the concern, or establishment, point of view. An establishment might remain intact at the same address but under a change of proprietorship, whereas a firm would be considered as dissolved with the withdrawal of the owners.

TABLE 66.—*Mortality by type of business, Minneapolis, St. Paul, and Duluth, 1926–30*

Type of business:	*Percentage of firms closing (5-year period)*[1]
Manufacturers	62.0
Wholesalers	66.1
Retailers	84.4

[1] The figures in the table represent the ratio of the number of concerns closed in the 5-year period to the number in the industry in 1930.

TABLE 67.—*Average life span by type of business, Minneapolis, St. Paul, and Duluth, 1926–30*

Type of business:	*Average number of years in business*
Manufacturers	8.0
Wholesalers	7.5
Retailers	6.0
Service	7.2

TABLE 68.—*Percentage distribution of closing and of opening enterprises, Minnesota cities, 1926–30*

Type of business	Percentage of firms	
	Closing	Opening
Manufacturing	9.9	9.2
Wholesale	6.9	6.2
Retail	56.4	55.0
Service	26.8	29.6
Total	100.0	100.0

In table 68 the proportions of new and of discontinuing firms are given for types of business. Of 12,213 firms closing in the period, 1926–30, more than 56 percent were retailers; and of the 11,905 new enterprises, 55 percent were retailers. For this period, only the service group had an excess of new over retiring enterprises, with 3,268 closing and 3,531 opening.

Although the numbers of firms decreased in three categories, it does not mean that the numbers of establishment declined. The census showed an increase. The apparent discrepancy may be accounted for in consolidations, disposal of local plants to be used as branches by outside companies, and the incorporation of independent outlets into chain systems.

Turning to the experience of Poughkeepsie, N. Y., a study [3] of the survival of business enterprises covering the period, 1844 to 1927, indicates that only 47 percent of retail, 45 percent of service, 53 percent of manufacturing, and 62 percent of wholesale establishments continued in existence more than 3 years.

Of 10,000 enterprises established in business in Poughkeepsie between 1844 and 1926, 30 percent remained in business only 1 year, 14 percent continued only 2 years, 21 percent survived more than 10 years. Since the study covered 82 years this category includes survivals for a range of 72 years.

The survival experience of wholesalers was superior to all other groups, with manufacturers second.

In tables 69 and 70 are recorded the life span of Poughkeepsie enterprises, in the first instance with changes in proprietorship not counted as new businesses, and in the second with changes in proprietorship included as entries.

Almost 10 percent of Poughkeepsie enterprises established between 1844 and 1916 continued existence more than 20 years. The classified record of this group is presented in table 71.

If changes in proprietorship are frequent, then, when counted as a business cessation, as in table 70, they should increase the total turn-over. In the first year, the percentages are greater in table 70 than in table 69, with the exception of service establishments. The total number of service organizations classified in table 69 is 2,618, as compared with 2,855 in table 70, a difference of 237, or 9 percent of the lesser total. Let us compare this with the other proportions:

	Retail	Wholesale	Manufacture	Craft	Service	Total
From table 70	5,567	183	1,194	1,423	2,855	11,222
From table 69	4,998	157	945	1,315	2,618	10,033
Difference	569	26	249	108	237	1,189
Difference as percent of totals, table 69	11	17	26	8	9	12

TABLE 69.—*Length of life of business enterprises established in Poughkeepsie between 1844 and 1926, not counting change in proprietorship as a new business*

	Retail	Wholesale	Manufacture	Craft	Service	Total
Number of enterprises	4,998	157	945	1,315	2,618	10,033
	Percentage distribution					
Years of life:[1]						
1	29.6	19.7	23.1	30.7	32.7	29.8
2	14.2	9.6	11.5	14.7	13.0	13.6
3	9.4	8.3	12.3	9.7	9.4	9.7
4	6.2	8.3	7.8	5.6	6.7	6.4
5	1.9	5.1	5.5	5.3	5.1	5.0
6	4.1	5.1	5.3	3.7	3.9	4.1
7	3.1	5.7	2.3	3.0	3.5	3.2
8	2.6	3.2	2.4	2.6	2.6	2.6
9	2.1	2.5	2.4	1.9	2.3	2.2
10	2.0	1.3	2.0	1.9	2.0	2.0
Over 10	21.8	31.2	25.3	20.9	18.8	21.4
Total	100.0	100.0	100.0	100.0	100.0	100.0

[1] Those concerns classified as living 1 year have been found in the directory for 1 year only. It is apparent that the actual existence of these concerns may vary from a period of considerably less than 1 year to a period of nearly 2 years. Likewise, those concerns classified as living 2 years have appeared in 2 successive directories and may have been in existence for a period of a little over 1 year to one of nearly 3 years.

[3] R. C. Hutchinson and A. R. and Mabel Newcomer; op. cit.

Thus we see that counting proprietorship changes would have its greatest significance in the case of manufacturers, and its least effect with craft enterprises. Since the number of retailer enterprises is almost one-half of the total of all establishments, the percentage difference of the latter is affected by the retail figures. The close agreement in the two cases, of the first year mortality percentages for service establishments has no vital significance.

On the other hand, including changes in proprietorships does have an effect upon the ranking of the types in first year mortality. It would be interesting to know the proportion of all such changes occurring within the first 12 months of the lives of concerns. The service group records the highest relative withdrawals in both instances; but when these changes are counted, the retail establishments displace the crafts in second place.

In both tables 69 and 70, the survival beyond the tenth year is highest for wholesalers, second highest for manufacturers, and third for retailers. As disclosed by table 71, the wholesale group leads, and the manufacturing group is second, in survival beyond 20 years.

TABLE 70.—*Length of life of business enterprises established in Poughkeepsie between 1844 and 1926, counting change in proprietorship as a new business*

	Retail	Wholesale	Manufacture	Craft	Service	Total
Number of enterprises	5,567	183	1,194	1,423	2,855	11,222
	Percentage distribution					
Years of life:						
1	32.5	22.4	24.0	31.9	32.9	31.5
2	13.3	9.8	13.1	14.8	14.3	13.7
3	9.2	11.5	12.7	9.8	9.6	9.8
4	6.1	8.2	8.0	6.2	6.9	6.5
5	5.1	6.0	5.4	5.4	5.3	5.2
6	4.2	6.6	4.5	3.7	4.0	4.2
7	3.1	5.5	2.7	3.1	3.3	3.2
8	2.8	1.6	2.9	2.5	3.0	2.8
9	2.3	2.2	2.7	2.2	2.2	2.3
10	2.2	1.1	2.7	2.2	1.9	2.1
Over 10	19.3	25.1	21.4	18.1	16.6	18.7
Total	100.0	100.0	100.0	100.0	100.0	100.0

TABLE 71.—*Business enterprises established in Poughkeepsie between 1844 and 1916 and lasting more than 20 years*

	Retail	Wholesale	Manufacture	Craft	Service	Total
Total number	3,763	108	846	1,062	2,007	7,786
Number lasting more than 20 years	373	18	107	98	162	758
Percent lasting more than 20 years	9.9	16.7	12.6	9.2	8.1	9.7

Since bankruptcy is a device for liquidation, by this procedure closures are not comparable with other discontinuances. But the experience of bankrupt concerns is significant. Of 709 Chicago [4] enterprises for which life span was calculated, 55 percent had been in existence 5 years or less at the time of petition for bankruptcy in 1930 and 1931. Sixty-nine percent had remained in business less than 8, and 65 percent less than 7 years.

[4] John H. Cover: Business and Personal Failure and Readjustment in Chicago, University of Chicago, August 1933.

CHANGES WITH TIME

It cannot be overemphasized that mortality of business enterprise is not chiefly a function of business depressions. The growth of business, as with the increase of population, presupposes an increase in the number dying. To the extent of a relation between human and business population, the former representing the clientele of the latter, an overoptimistic increase in the number of establishments would naturally result in an increase in the rate of entry and subsequently of closure.

As illustrative of the long-time growth of bankruptcies, the following notes are significant:

For the period 1916–31 the average annual increase in the number of closed cases in the Chicago [5] area was 68, representing 5 percent of the average number for the period.

The annual average increase in the number of bankruptcies in the United States, for the years 1911 through 1931, was 2,428. The southern Federal district of New York, including New York City, accounted, on an average, for about 38 percent of the number of bankruptcies in the United States.

As an example of fluctuations in the relationship of numbers of persons and numbers of business establishments, Poughkeepsie [6] rates at 30-year intervals are entered in table 72. The number of persons per establishment for all concerns, listed in the final column, is of little significance due to the preponderance of retail concerns in the aggregate and the differences in rates as between business types. For the period beginning in 1873, the rates for manufacturers and for wholesalers have been moving in opposite directions. Retail and service groups show rates alternately high and low.

TABLE 72.—*Number of people per business establishment* [1]*—Poughkeepsie*

Year	Retail	Wholesale	Manufacture	Craft	Service	Total
1842	96		399	151	417	46
1873	78	3,074	250	346	195	40
1903	97	1,910	455	429	209	50
1933	72	1,063	545	305	121	35

[1] The population figure used is that for the city and 4 surrounding towns. It has been assumed that the increase in population between census years is equal in amount each year.

TABLE 73.—*Length of life of business enterprises in Poughkeepsie in 3 30-year periods, 1844–1933*

Years of life	Cumulative percentage distribution			Years of life	Cumulative percentage distribution		
	1844–73	1874–1903	1904–33		1844–73	1874–1903	1904–33
Retail:				Wholesale—Con.			
1 or less	34	27	30	3 or less	71	29	35
2 or less	50	40	44	Over 3	29	71	65
3 or less	60	49	53	Manufacture:			
Over 3	40	51	47	1 or less	25	24	22
Wholesale:				2 or less	38	38	33
1 or less	43	19	18	3 or less	48	50	44
2 or less	57	27	27	Over 3	52	50	56

[5] John H. Cover; op cit.
[6] R. G. Hutchinson and A. R. and Mabel Newcomer; op. cit.

A comparison of the life span of manufacturing, wholesaling, and retailing concerns in three different periods of 30 years each, is presented for Poughkeepsie in table 73. Relatively, wholesaling has shown a distinct improvement. First-year mortality has been reduced, on an average, for this group from 43 percent of the new concerns to 18 percent, and the proportion continuing in business beyond 3 years has increased from 29 to 65 percent. The manufacturing group has not alone outstripped the retailer, but, in addition, has increased the proportion continuing beyond 3 years, in the most recent period as compared with the middle period.

LIFE SPAN AND NET WORTH

In our examination of the relations of life span to initial capital investments in retail and manufacturing firms, the "shoestring" nature of the large majority of enterprises was observed. We are now in position to compare the types of business enterprise in three Minnesota [7] cities with respect to pecuniary strength.

Only one-third of all concerns, as indicated in table 74, had initial capital of $2,000 or more. Of firms rated, just over one-half of the number was in the retail, and one-fifth in the service group.

Length of life, on an average, as related to investment is summarized in table 75. The apparent advantage of large capital is readily seen, though the conglomerate nature of firms and fields included does not contribute much to the picture.

TABLE 74.—*Number of business firms in 3 Minnesota cities classified by type and net worth, 1930* [1]

Type	$500,000 and over	$75,000 to $500,000	$10,000 to $75,000	$2,000 to $10,000	Less than $2,000 or unclassified	Total	Percentage of all firms
Manufacturing	97	226	425	225	1,001	1,974	12.3
Wholesale	94	210	345	112	485	1,246	7.7
Retail	42	177	872	1,587	5,497	8,175	50.8
Service	23	86	453	620	3,512	4,694	20.2
Total	256	699	2,095	2,544	10,495	16,089	100.0
Percentage of all firms	1.6	4.3	13.1	15.8	65.2	100.0	

[1] The classification of the concerns according to credit ratings or "estimated pecuniary strength" gives a rough measure of the owner's investment, but contains a bias upward in the case of single proprietorships and partnerships, since private properties are usually included in the estimate for these concerns. In the firms with ratings of over $5,000 an attempt has been made to eliminate these private assets from the estimate and these may therefore be accepted as substantially correct.

TABLE 75.—*Average life of business firms in 3 Minnesota cities classified by net worth, 1926–30*

Net worth	Number of years
$500,000 and over	33.2
$75,000 to $500,000	30.0
$10,000 to $75,000	17.7
$2,000 to $10,000	9.4
Less than $2,000 or unclassified	5.2
All firms	6.6

Numbers of new and discontinuing firms, and ratios of these numbers to total numbers in business in 1930, both related to investment, are given in tables 76 and 77, respectively. The shift in the grain

[7] E. A. Heilman; op. cit.

and milling industries of this area may have affected the sample and restricted the application to a wider field.

In discussing the tabulations, Heilman comments as follows:

> No reasonable interpretation of these changes can be made without taking into consideration the numbers of establishments operating in each type of business. A ratio has been calculated between the number of closings and openings and the total number in the industry. This ratio is expressed as the number of closings or openings during the 5-year period 1926–30 per hundred in operation at the end of 1930.

Table 77 is a summary of these ratios for the different types of industry grouped according to various investment value classes.

TABLE 76.—*Number of business firms closed and opened in 3 Minnesota cities classified by type and net worth, 1926–30*

Type	$500,000 and over		$75,000 to $500,000		$10,000 to $75,000		$2,000 to $10,000		Less than $2,000 or unclassified		Total		Percentage of all firms	
	Closed	Opened	Closed	Opened	Closed	Opened	Closed	Opened	Closed	Opened	Closed	Opened	Closed	Opened
Manufacturing	16	3	34	23	152	124	149	168	874	785	1,225	1,103	9.9	9.2
Wholesale	15	2	40	20	117	98	90	114	561	496	823	730	6.9	6.2
Retail	3	1	32	20	218	179	871	784	5,773	5,557	6,897	6,541	56.4	55.0
Service	5	3	11	15	107	90	239	261	2,906	3,162	3,268	3,531	26.8	29.6
Total	39	9	117	78	594	491	1,349	1,327	10,114	10,000	12,213	11,905	100.0	100.0
Percentage of all firms closed or open	0.3	----------	0.9	0.7	4.9	4.1	11.0	11.2	82.9	84.0	100.0	100.0	----------	----------

A comparison of the ratios in table 77 with the absolute numbers in table 76 shows clearly that the large number of changes in retailing and in service enterprises are due not merely to the large numbers in the business but also to heavier mortality rates.

The death rate for all retail stores is 84.4 per hundred in existence in 1930, for service firms 69.6, for wholesale 66.1, and for manufacturing 62.0. There is a surprisingly close correspondence between manufacturing, wholesaling, and service enterprises in the death rate per hundred. (It should be remembered that the death rate here calculated is not an annual rate but covers a 5-year period.)

Heilman reaches the conclusion from examination of the 5-year death rates that—

investment is the decisive factor in determining the ability of business enterprises to survive. Type of business is of little significance. The firms with substantial amounts of capital survive the longest, and those types of business including the firms with large investments have the lowest mortality rates. The lowest rate is that for manufacturing, 62.0, about 12.4 a year, and the probable life expectancy for the average firm is therefore 8 years.

TABLE 77.—*5-year turn-over ratios of business firms in 3 Minnesota cities classified by type and net worth, 1926–30* [1]

	$500,000 and over		$75,000 to $500,000		$10,000 to $75,000		$2,000 to $10,000		Less than $2,000 or unclassified		Total	
	Closed	Opened	Closed	Opened	Closed	Opened	Closed	Opened	Closed	Opened	Closed	Opened
Manufacturing	16.5	3.1	15.0	10.2	35.8	29.2	66.3	74.8	87.4	78.5	62.0	55.9
Wholesale	15.9	2.1	19.0	9.5	34.0	28.4	80.5	102.0	113.8	102.1	66.1	58.6
Retail	7.1	2.4	18.1	11.3	25.0	20.5	55.0	49.4	105.0	101.1	84.4	80.0
Service	21.7	13.0	12.8	17.5	23.6	19.8	38.6	42.1	82.7	90.0	69.6	75.2
Investment class as a whole	15.2	3.5	16.6	11.3	28.3	23.4	53.0	52.2	96.5	95.4	76.0	74.2

[1] The figures in the table represent the ratio of the number of concerns closed or opened in the 5-year period to the number in the industry in 1930. For example, the first figures for manufacturing in the $500,000 class indicate that for every 100 in the group in 1930, 16.5 closed and 3.1 opened during the 5-year period.

FORM OF ORGANIZATION

Chicago [8] establishments which survived 5 years or less before entering bankruptcy represented all forms of business organization. Of the 1,012 bankrupt enterprises studied, 67 percent of the partnerships, 59 percent of the individual proprietorships, and 55 percent of the corporations failed to reach their sixth birthdays.

The Poughkeepsie study [9] of 12,618 business units listed 78 percent of the enterprises as individual proprietorships. As indicative of the size of the establishments represented, only 14 percent of the manufacturing firms were incorporated. Table 78 offers a percentage distribution of Poughkeepsie business according to organization type. Perhaps the extent of partnership control of manufacturing and wholesaling enterprise is another indication of the small-size local nature of the business.

A comparison of the life span of corporate and of all concerns is presented in table 79. Although manufacturing corporations

[8] John H. Cover: op. cit.
[9] R. G. Hutchinson and A. R. and Mabel Newcomer: op. cit.

appear to be at an advantage in survival during the early years of business existence, by the end of the tenth year, the advantage appears to have disappeared.

TABLE 78.—*Form of organization, Poughkeepsie*

	Retail	Wholesale	Manufacture	Craft	Service	Total
Number of enterprises	6,230	245	1,095	1,595	3,453	12,618
	Percentage distribution					
Individual enterprise	77.2	59.6	51.7	88.3	84.9	78.2
Partnership	11.4	22.7	22.2	5.8	9.0	11.2
Corporation	2.8	8.2	13.7	.8	1.6	3.2
All other	8.6	9.5	12.4	5.1	4.5	7.4
Total	100.0	100.0	100.0	100.0	100.0	100.0

TABLE 79.—*Comparison of length of life of corporations and all forms of business enterprises, Poughkeepsie, 1844–1927*

Years of life	Cumulative percentage distribution									
	Retail		Wholesale		Manufacture		Craft		Service	
	All concerns	Corporations	All concerns	Corporations	All concerns	Corporations	All concerns	Corporations	All concerns	Corporations
1 or less	30	20	20	10	23	10	31	0	33	23
2 or less	44	32	29	30	35	26	45	0	46	37
3 or less	53	44	38	30	47	40	55	0	55	43
4 or less	59	52	46	30	55	48	61	0	62	49
5 or less	64	58	51	40	60	55	66	0	67	52
6 or less	68	63	56	40	66	63	70	0	71	52
7 or less	72	65	62	40	68	69	73	0	74	57
8 or less	74	66	65	50	70	73	75	33	77	57
9 or less	76	68	68	50	73	75	77	33	79	66
10 or less	78	69	69	50	75	76	79	33	81	69
Over 10	22	31	31	50	25	24	21	67	19	31
Number of cases	4,998	117	157	10	945	108	1,315	3	2,618	35
Percent incorporated	2.9		6.4		11.4		0.2		1.3	

Although treatment of business growth and change is presented in another section, realization of the continuous flux in the forms of organization is important at this point. Based upon the story of industrial evolution, there appears to be a general impression that a small business begins as an individual proprietorship, grows by the addition of partners who bring more capital and acumen, and blossoms into a corporation with diversified management and ownership.

Based upon the records of 77,000 cases indicating succession,[10] table 80 presents a summary of changes in organization in the first 6 months of 1936. To assure clarity, the change may be traced as follows:

Of the total of manufacturing enterprises, 45 percent were individual proprietorships before the change. After the change, 17 percent were still individual proprietorships. However, in the case of 14 percent, the new form of organization was partnership; and the succeeding form of another 14 percent was corporate. Thus the 45 percent of

[10] William A. Rothmann: Business Births and Deaths, Dun's Review, June 1937.

manufacturing concerns starting as proprietorships have been accounted for.

TABLE 80.—*Percentage distribution of types of organization before and after change (first 6 months of 1936)*

MANUFACTURING

Before (percent of total)			After (percent of total)
45	Proprietorships became	Proprietorships	17
		Partnerships	14
		Corporations	14
32	Partnerships became	Proprietorships	15
		Partnerships	6
		Corporations	11
23	Corporations became	Proprietorships	6
		Partnerships	4
		Corporations	13
100			100

WHOLESALE

Before (percent of total)			After (percent of total)
44	Proprietorships became	Proprietorships	15
		Partnerships	12
		Corporations	17
34	Partnerships became	Proprietorships	17
		Partnerships	6
		Corporations	11
22	Corporations became	Proprietorships	7
		Partnerships	6
		Corporations	9
100			100

RETAIL

Before (percent of total)			After (percent of total)
70	Proprietorships became	Proprietorships	52
		Partnerships	14
		Corporations	4
23	Partnerships became	Proprietorships	17
		Partnerships	4
		Corporations	2
7	Corporations became	Proprietorships	4
		Partnerships	1
		Corporations	2
100			100

In the case of partnerships, representing before the change 32 percent of all manufacturing enterprises, almost one-half, 15 percent, revert to proprietorships. Frequently, this is due to disagreement between partners, or the withdrawal or death of a partner.

The change from the corporate form to proprietorship or partnership would appear a complete reversal of general tendency. However, adjustments to tax levies or to other regulations regarded as restrictive or discriminatory may account for a large part of this change.

Examining the right-hand column of table 80, representing successions or the "after" form, we may now summate the percentages. First, the proprietorships. Adding 17, 15, and 6 percent, we have a total of 38 percent, or 7 percent less "after" than "before." We discover, also, a decline in partnerships from 32 to 24 percent. The proportion of corporations has risen from 23 to 38 percent.

To discover the net results of these changes, the following summary is offered:

	Manufacture		Wholesale		Retail	
	Before	After	Before	After	Before	After
	Percent	*Percent*	*Percent*	*Percent*	*Percent*	*Percent*
Proprietorship	45	38	44	39	70	73
Partnership	32	24	34	24	23	19
Corporation	23	38	22	37	7	8
Total	100	100	100	100	100	100

In general, the corporate form became more important, relatively, and the partnerships less popular. But in the retail field, resort to proprietorships increased, reversing the trend among the manufacturing and wholesaling groups.

But the status referred to as "after" will become the "before" in the next moment of time. The dynamic changes illustrated here occur almost too rapidly to be observed for analysis. And yet the estimate of survival, mortality, and life span, and prescriptions for many of the ills of business life, are currently dependent upon diagnoses of symptoms so fleeting and so vague.

CHAPTER V

CHANGES IN BUSINESS POPULATION

In seeking information disclosing business life span and factors associated with mortality, we were compelled by the lack of information on the total problem to make an arduous study of small fragments of the business population in scattered communities. But we have no basis for determining to what extent these facts represent the more than 2.2 million establishments estimated by the Bureau of the Census as currently in business. It is to that problem that attention will be drawn in the next two chapters.

Based upon 680,000 new concerns listed by Dun & Bradstreet [1] in the four quarters of 1936 and three quarters of 1937, there are, on an average, approximately 390,000 new enterprises per year, or a birth rate annually of 191 per 1,000 of firms in business.

The annual mortality of about 340,000, based upon 595,000 disappearances in the same 7 quarters, gives a death rate of 167 per 1,000 listed firms.

Consequently, the net gain was at the rate of about 50,000 per year, or 24 per 1,000 firms.

In these analyses both industrial and commercial enterprises were included while the following were excluded: Financial institutions, railroads, professional enterprises, such as lawyers and doctors, and other types not ordinarily concerned with commercial credit.

Since about 75 percent of all changes relate to retail enterprises, table 81 is a significant summary, by quarters, of changes occurring within the period.

But not all discontinuances are failures, and the proportions of discontinuances which are due to failure vary widely by industrial divisions, as is recorded in table 82. Included among failures in the third column are 77B cases, under bankruptcy-law reorganization at that time.

TABLE 81.—*Changes in retail population by quarters, January 1936–September 1937*

[In thousands of enterprises]

Year and quarter	New	Discontinuing	Succession, no ownership change	Net gain
1936:				
I	68.7	67.3	8.6	1.4
II	78.2	63.8	8.5	14.4
III	72.0	58.3	7.8	13.6
IV	75.7	66.4	7.9	9.3
1937:				
I	67.2	66.8	8.3	.4
II	73.8	61.7	8.4	12.0
III	67.7	55.2	7.2	12.5

[1] William A. Rothmann: Business Births and Deaths, Dun's Review, March 1938, pp. 12–14.

TABLE 82.—*Business disappearances and business failures, by major divisions of industry, January 1936–September 1937*

	Total outs	Failures and 77B cases	Number outs per failure
Manufacturing	63,808	3,235	19.7
Wholesaling	30,035	1,691	17.8
Retailing	439,538	9,726	45.2
Construction	23,309	943	24.7
Commercial service	37,113	896	41.4

From data upon listings of Dun & Bradstreet [2] for the first 6 months of 1936, it appears that for every one enterprise discontinuing with legal formality, 30 leave business less formally. When successions without change of ownership are eliminated, failures represent a ratio of 1 to 18 total discontinuances.

The authors find that the distribution of total births and deaths by industries seems to correspond with general impressions as to their relative importance in the total, when measured by number of enterprises. In every group, the new enterprises exceeded the disappearances, although for commercial service, the margin was slight. Retail trade, accounting for nearly three-fourths of the total, obviously dominates the record. The exact significance of the construction figures is somewhat confused by the character of the industry itself, with its many in-and-out operators, now working as independent subcontractors and now as skilled laborers in someone else's employ. Commercial service also is a less exact area.

TABLE 83.—*Distribution of business births and deaths by industrial divisions*

[Data for first 6 months of 1936]

	New enterprises	Disappearances
	Percent	*Percent*
Manufacturing	10.3	10.2
Wholesale	5.5	5.0
Retail	73.9	74.5
Construction	4.6	4.0
Commercial Service	5.7	6.3
Total	100.0 (199,000)	100.0 (176,000)

TABLE 84.—*Relative changes in enterprises by industrial divisions*

[Data for first 6 months of 1936]

	New concerns (base)	Proportionate to number of new concerns			
		Successions	Net new	New out [1]	Gain
Manufacturing	100	32	68	56	12
Wholesale	100	32	68	48	20
Retail	100	41	59	49	10
Construction	100	25	75	51	24
Commercial Service	100	38	62	59	3
Total	100	39	61	50	11

[1] The net out figure is obtained by deducting the number of successions from the total outs. This is not strictly accurate, since the successions are recorded when the new enterprise is formed. However, if one assumes a fairly uniform rate, then the discrepancy between successions on the birth side and on the death side will be not great.

[2] Willard L. Thorp and William A. Rothmann: "Business Births and Deaths," Dun's Review, February 1937, pp. 10–11, 46.

BIRTH RATES COMPARED

An estimate of the rapidity with which new enterprises appeared in various industries during the first 6 months of 1936 is summarized [3] in table 85. The author urges care in interpretation as follows:

This table is a comparison of birth rates only. Its essential significance therefore is the measures of mobility of life in these contrasting kinds of enterprises, the speed with which new concerns made their appearance during the kind of an economic period through which we have just passed.

The third column entitled "Probable Birth Rate Ranking" becomes therefore a picture of relative volatility and not of net growth.

The first column represents merely the relative percentage of concerns that each industry constitutes of all concerns within its census classification, and that the second column indicates merely the percentage of new concerns in each classification that each industry constitutes. Furthermore, the new concern percentages are not to be considered as indicating net increases of the number of concerns in each industry as the figures upon which they are based will be modified and in some instances completely offset by the deaths and disappearances.

TABLE 85.—*Probable birth rate ranking of divisions of industry*

[Data for first 6 months of 1936]

	All concerns (1935 census)	New concerns	Probable birth rate ranking
	Percent	*Percent*	
Manufacturing:			
Fuels	0.6	2.8	1
Transportation equipment	1.2	2.0	2
All other industries	11.6	18.7	3
Iron and steel	4.4	7.1	4
Chemicals and drugs	4.1	5.7	5
Stone, clay, glass, and products	3.2	4.3	6
Forest products	6.7	9.0	7
Leather and leather products	2.4	2.6	8
Textiles	15.2	12.6	9
Machinery	7.7	6.2	10
Paper, printing, and publishing	15.2	12.0	11
Foods	27.7	17.0	12
Total	100.0	100.0	
Retail trade:			
Automotive products	19.3	25.7	1
Farm supplies, general stores	4.1	5.2	2
Furniture, household furniture	2.8	3.3	3
Lumber, building materials, hardware	4.5	4.3	4
Foods	33.4	31.6	5
Apparel	5.8	5.4	6
General merchandise	2.7	2.4	7
Restaurants	15.4	12.8	8
All other lines	8.5	6.9	9
Drugs	3.5	2.4	10
Total	100.0	100.0	
Wholesale trade:			
Fuels	1.6	6.4	1
Lumber, building materials, hardware	4.4	9.1	2
Farm products, foods, groceries	23.8	40.9	3
Automotive products	6.4	9.6	4
Clothing and furnishings	4.5	4.4	5
Dry goods and textiles	4.1	3.7	6
Chemicals and drugs	3.3	2.3	7
Supply houses	10.1	4.9	8
All other lines	41.8	18.7	9
Total	100.0	100.0	

[3] William A. Rothmann: "Business Births and Deaths," Dun's Review, April 1937, pp. 19-20.

TENDENCIES IN BUSINESS GROWTH

While changes are occurring within the year or within short range periods, it is important to view the picture in the perspective of a long period. It is possible to accomplish this by reference[4] to table 86.

Total concerns recorded grew in number steadily from 1900 through 1917, receded slightly for 2 years, and then climbed again to a maximum for the period in 1929 with 2,213,000. The succeeding drop reached a low of 1,961,000 in 1933. Subsequent increases brought the 1938 total to 2,102,000.

With the exception of 1917 and from 1930 through 1932, new enterprises outnumbered discontinuances each year. In the 39-year period 15,989,000 new concerns were established and 14,013,000 closed their doors, a startling turn-over.

The proportions of entries and of departures to the total of concerns in business are calculated[5] in table 87. Contrasts of 1920 and of 1933 offer evidence of year-to-year differences.

Of the discontinuances recorded,[5] the proportions closing with losses to creditors fluctuated from 2.4 percent in 1936 to 8.3 percent in 1932.

TABLE 86.—*United States business population*

[In thousands]

Year	Total listed concerns[1]	New enterprises[2]	Total discontinued[3]	Year	Total listed concerns[1]	New enterprises[2]	Total discontinued[3]
1900	1,174	272	248	1920	1,821	459	353
1901	1,219	286	248	1921	1,927	483	427
1902	1,253	304	265	1922	1,983	491	478
1903	1,281	305	272	1923	1,996	469	417
1904	1,320	308	268	1924	2,047	477	411
1905	1,357	329	287	1925	2,113	496	451
1906	1,393	334	299	1926	2,158	484	471
1907	1,418	339	302	1927	2,172	483	456
1908	1,448	361	325	1928	2,199	476	463
1909	1,486	360	331	1929	2,213	453	483
1910	1,515	358	348	1930	2,183	423	481
1911	1,525	365	326	1931	2,125	355	404
1912	1,564	369	316	1932	2,077	338	454
1913	1,617	387	348	1933	1,961	345	332
1914	1,655	388	369	1934	1,974	379	319
1915	1,675	380	347	1935	1,983	392	385
1916	1,708	369	344	1936	2,010	408	382
1917	1,733	361	385	1937	2,057	400	351
1918	1,708	307	305	1938	2,102	388	365
1919	1,711	308	197				

[1] Total listed concerns refers to the total of industrial and commercial names in the July issue of the Dun & Bradstreet Reference Book. In general it excludes financial institutions including banks, railroads, professional enterprises such as lawyers and doctors, farmers and others not ordinarily users of commercial credit in the accepted sense. In general, branches are listed, except in the case of chain distributors.

[2] New enterprises refer to names added, but does not include cases arising from change in style or geographical location within the community. The figures refer to calendar years.

[3] Discontinued enterprises include those which have discontinued operation as a result of any of the following types of action: Assignment, attachment, voluntary petition, involuntary petition, receivership, absconding, compromise, execution, foreclosure and other voluntary discontinued operations in which there is no official record of loss to creditors. The figures refer to calendar years.

TABLE 87.—*Changing percentages of all concerns represented by new and discontinuing enterprises*

	Percent entries of concerns in business	Percent closures of concerns in business		Percent entries of concerns in business	Percent closures of concerns in business
1920	25.2	19.3	1934	19.2	18.5
1925	23.5	21.3	1935	19.8	19.1
1930	19.4	22.6	1936	20.3	19.0
1931	16.7	19.4			
1932	16.3	18.6	Period average	18.5	20.1
1933	17.6	23.5			

[4] Dun & Bradstreet, Inc.: Vital Statistics of Industry and Trade.

[5] Roy A. Foulke: Behind the Scenes of Business, rev. ed., 1937. Dun & Bradstreet, Inc.

FAILURES

In table 88 estimates [6] of numbers of commercial failures, with aggregate assets and total and average liabilities give an impression of the size of the problem. The number of failures reported here for 1937 is 9,017 as contrasted with 9,490 by Dun & Bradstreet. The difference is attributed to the omission by the census from its aggregates of those figures added by Dun & Bradstreet beginning with June, 1934.

In 1936, of 9,185 failures, 9,007 each recorded liabilities under $100,000. The average was $10,280.[7]

Table 89 offers a comparison [8] for the calendar years 1938 and 1937 of commercial failures classified by industrial groups, and the corresponding liability values in thousands of dollars. The relation of numbers of failures and of liabilities is typical. While retail trade accounted for almost 8,000 of the 12,836 failures in 1938, the liabilities of the manufacturing group exceeded those of the retail trade, $98,251,000 and $76,528,000 respectively. It will be recalled that a total of 2,102,000 concerns was listed for 1938, with 388,000 entries and 365,000 exits.

TABLE 88.—*Commercial failures: Number and assets and liabilities*

NOTE.—In January 1936 statistics were revised to exclude failures of insurance and real-estate agents and brokers, holding and finance companies, shipping agents, tourist companies, transportation terminals and the like, all of which were formerly included. These revisions bring the failure record more nearly in accordance with the type of concerns covered by "Total Number of Concerns in Business," in which no changes were made. The following table presents revised statistics beginning with January 1933.

Year	Total number of concerns in business	Number of failures	Assets	Liabilities	Average liability
1915	1, 674, 788	22, 156	$183, 454, 000	$302, 286, 000	13, 644
1916	1, 707, 639	16, 933	113, 599, 000	196, 212, 000	11, 547
1917	1, 733, 225	13, 855	103, 465, 000	182, 441, 000	13, 168
1918	1, 708, 061	9, 982	101, 638, 000	163, 020, 000	16, 331
1919	1, 710, 909	6, 451	67, 038, 000	113, 291, 000	17, 561
1920	1, 821, 409	8, 881	195, 504, 000	295, 122, 000	33, 230
1921	1, 927, 304	19, 652	409, 038, 000	627, 402, 000	31, 926
1922	1, 983, 106	23, 676	413, 358, 000	623, 896, 000	26, 351
1923	1, 996, 004	18, 718	388, 382, 000	539, 387, 000	28, 816
1924	2, 047, 302	20, 615	337, 945, 000	543, 225, 000	26, 351
1925	2, 113, 312	21, 214	248, 067, 000	443, 744, 000	20, 918
1926	2, 158, 457	21, 773	202, 345, 000	409, 232, 000	18, 795
1927	2, 171, 688	23, 146	256, 740, 000	520, 104, 000	22, 471
1928	2, 199, 049	23, 842	255, 478, 000	489, 460, 000	20, 533
1929	2, 212, 779	22, 909	226, 028, 000	483, 250, 000	21, 094
1930	2, 183, 008	26, 355	442, 800, 000	668, 284, 000	25, 357
1931	2, 125, 288	28, 285	434, 939, 000	736, 309, 000	26, 032
1932	2, 076, 580	31, 822	509, 135, 000	928, 313, 000	29, 172
1933 [1]	1, 960, 701	20, 307	270, 730, 000	502, 831, 000	24, 761
1933 [1]	1, 960, 701	19, 859	251, 875, 000	457, 520, 000	23, 038
1934	1, 973, 900	11, 724	143, 675, 000	230, 198, 000	19, 635
1935	1, 982, 905	11, 510	94, 867, 000	183, 013, 000	15, 900
1936	2, 009, 935	9, 185	77, 108, 000	147, 253, 000	16, 032
1937	2, 056, 598	9, 017	67, 537, 000	115, 594, 000	12, 820

[1] See headnote regarding revisions. Figures for 1933 (first row) are on the old basis and are comparable with figures for earlier years; other figures for 1933 and those for subsequent years are the revised series.

Source: Bureau of the Census: Proof sheet of the 1938 edition of the Census Abstract, p. 298.

[6] Bureau of the Census: Proof sheet of the 1938 ed., Census Abstract, p. 298.
[7] Roy A. Foulke: Op. cit.
[8] Dun's Review, February 1939: Analyzing the Record of Industrial and Commercial Failures.

TABLE 89.—*Failures by divisions of industry—yearly totals 1938 and 1937*

	Number of failures		Liabilities (thousands of dollars)	
	1938	1937	1938	1937
Total United States	12, 836	9, 490	246, 505	183, 253
Manufacturing (total)	2, 428	1, 997	98, 251	91, 776
Foods	445	497	15, 316	16, 933
Textiles	597	413	16, 818	17, 627
Forest products	210	155	6, 417	5, 409
Paper, printing, publishing	98	161	6, 675	5, 381
Chemicals, drugs	48	71	2, 126	1, 504
Fuels	80	45	19, 504	13, 666
Leather and products	82	74	2, 016	2, 179
Stone, clay, glass	142	63	3, 783	4, 866
Iron and steel	156	100	8, 616	5, 333
Machinery	57	115	6, 084	7, 716
Transportation equipment	327	56	3, 403	4, 124
All others		247	7, 493	7, 038
Wholesale trade (total)	1, 289	1, 003	49, 732	21, 274
Farm products, food	467	379	8, 420	6, 652
Clothing and furnishings	105	57	1, 789	607
Dry goods, textiles	52	38	1, 258	779
Lumber	100	79	4, 451	1, 954
Chemicals, drugs	46	55	22, 502	1, 311
Fuels	31	36	1, 654	1, 927
Automotive products	96	83	1, 744	1, 630
Supply houses	108	52	1, 578	916
All other	284	224	6, 336	5, 498
Retail trade (total)	7, 925	5, 423	76, 528	46, 740
Foods	2, 066	1, 780	11, 387	10, 444
Farm supplies	287	265	2, 474	2, 432
General merchandise	401	246	4, 333	2, 055
Apparel	1, 807	951	16, 866	7, 144
Furniture	610	263	10, 043	3, 238
Lumber	406	304	4, 655	3, 020
Automotive products	659	421	10, 485	5, 611
Restaurants	699	508	7, 693	6, 565
Drugs	460	328	3, 812	2, 786
All other	530	357	4, 780	3, 445
Construction (total)	625	584	10, 081	11, 625
General contractors	78	77	1, 376	1, 531
Carpenters and builders	180	184	4, 274	5, 002
Building subcontractors	345	307	3, 518	4, 350
Other contractors	22	16	913	724
Commercial service (total)	569	483	11, 913	11, 838
Cleaners, dyers	128	97	1, 309	1, 050
Haulage, busses, taxis	148	150	3, 200	5, 524
Hotels	46	37	3, 856	1, 978
Laundries	52	37	1, 622	1, 138
Undertakers	51	39	473	285
All others	144	123	1, 453	1, 863

While the aspects of the relation of the numbers of failures to assets and liabilities are discussed in other sections of this survey, it is important to give here a picture of certain relationships over a period of years. In table 90, in addition to the numbers and liabilities of bankruptcies, the small proportions of realizations are recorded.[9]

Analyzing numbers of bankruptcies and liabilities for the period 1916 through 1931, it was found[10] that the increase in numbers of

[9] Louis P. Starkweather and Edward H. Bishara: Reported by U. S. Department of Commerce, Division of Business Review, October 1938.
[10] John H. Cover: Business and Personal Failure and Readjustment in Chicago, University of Chicago, August 1933.

bankruptcies annually approximated 5 percent of the average for the period, whereas the increase in liabilities was 8 percent annually. However, when the liabilities were adjusted for changes in the value of the dollar, the annual average increase was 4.9 percent of the average for the period.

It is estimated that approximately 20 manufacturing enterprises discontinue for every 1 that passes through bankruptcy, and in retailing the ratio is 45 to 1. With this in mind, certain discrepancies would appear in the differences between tables 82, 88, and 90. For instance, in table 88 the total number of failures for 1937 is 9,017, whereas in table 90 the number of bankruptcies is 55,115 for the same year. The answer is that the data, while comparable within tables, are not classified in such manner as to be comparable as between tables.

TABLE 90.—*Bankruptcy liquidations—1920–37*

Fiscal years ended June 30	Total liabilities (000 omitted)	Total assets realized (000 omitted)	Total paid to creditors (000 omitted)	Expenses of liquidation (000 omitted)	Cents paid per dollar of liability or percent of liability paid	Cents of liquidation per dollar of total asset realized	Total number of cases	Number of no-asset cases	Ratio of no-asset cases to total, percent
1920	$201, 626	$29, 599	$22, 223	$6, 355	11. 02	21. 47	15, 622	9, 000	57. 6
1921	171, 284	27, 278	21, 511	4, 835	12. 56	17. 72	15, 200	8, 480	55. 8
1922	255, 614	37, 900	29, 434	7, 357	11. 52	19. 41	22, 517	10, 082	44. 8
1923	486, 401	61, 861	47, 998	12, 041	9. 87	19. 66	34, 401	17, 758	51. 6
1924	663, 645	71, 587	54, 523	15, 306	8. 22	21. 38	41, 649	22, 316	53. 6
1925	747, 523	85, 349	63, 528	18, 522	8. 50	21. 70	44, 440	23, 694	53. 3
1926	806, 313	93, 018	70, 765	19, 842	8. 78	21. 33	47, 307	26, 913	56. 9
1927	885, 557	96, 559	72, 094	21, 342	8. 14	22. 10	48, 269	28, 062	58. 1
1928	830, 789	90, 540	66, 693	21, 512	8. 03	23. 76	53, 392	30, 405	56. 7
1929	883, 606	88, 964	66, 323	19, 949	7. 51	22. 42	57, 039	35, 572	62. 4
1930	948, 258	106, 245	81, 827	22, 220	8. 63	20. 91	60, 568	38, 116	63. 0
1931	1, 008, 654	89, 535	67, 620	19, 777	6. 70	22. 09	60, 322	30, 507	63. 8
1932	1, 260, 230	85, 577	63, 028	18, 683	5. 00	21. 83	63, 502	38, 760	61. 0
1933	1, 627, 066	115, 789	87, 282	24, 109	5. 36	20. 82	67, 031	38, 181	57. 0
1934	1, 589, 816	81, 501	61, 580	18, 217	3. 87	22. 35	63, 482	37, 099	58. 4
1935	1, 518, 932	63, 073	47, 352	15, 721	3. 12	24. 93	56, 483	37, 027	65. 6
1936	1, 400, 000	85, 084	66, 692	17, 953	4. 76	21. 10	52, 339	38, 867	74. 3
1937	1, 224, 789	63, 484	48, 593	15, 404	3. 93	24. 24	55, 115	42, 396	76. 9
Total, 1920–37, 18 years	16, 510, 103	1, 372, 943	1, 039, 066	299, 145			858, 858	521, 235	
Average per year, 1920–37	917, 228	76, 275	57, 726	16, 619	6. 29	21. 79	47, 714	28, 957	60. 7

In addition to exclusions from the Dun and Bradstreet records previously explained, the differences in classification are due in part to the use of calendar years for the failure data and fiscal years for the bankruptcy figures.

SHORT-PERIOD MOVEMENT

In addition to growth over a long historical period, there are many changes, small or violent, occurring from day to day, seasonably, or every few years as economic and social conditions vary.

In table 91 are presented the number of failures per 10,000 of listed commercial enterprises.[11] Two figures are given for 1933; revision of current figures eliminating real estate and financial companies have been carried back only to that year. Even with this alteration, the rates vary significantly within the recent period. Since the data are

[11] Dun's Review, February 1939; Op. cit.

expressed as rates, and since both the numbers of failures and of total concerns change, the figures in the table give a moving picture of the relative welfare of enterprise.

TABLE 91.—*Insolvency index 1895–1938—apparent annual number of failures for each 10,000 listed commercial enterprises*

Year	Index	Year	Index	Year	Index	Year	Index	Year	Index
1895	111.7	1904	92.3	1913	98.1	1922	119.8	1931	133.4
1896	133.4	1905	84.9	1914	117.6	1923	93.4	1932	154.1
1897	124.7	1906	76.8	1915	132.7	1924	100.0	1933	102.6
1898	110.6	1907	82.8	1916	99.7	1925	100.4	1933	100.3
1899	82.1	1908	108.2	1917	80.3	1926	101.0	1934 [1]	61.1
1900	91.6	1909	87.1	1918	58.7	1927	106.4	1935	61.7
1901	90.4	1910	83.8	1919	37.4	1928	108.5	1936	47.8
1902	93.1	1911	88.0	1920	48.3	1929	103.9	1937	45.9
1903	94.0	1912	99.8	1921	101.9	1930	121.6	1938	61.1

[1] New series; real estate and financial companies omitted.

Both as evidence of continual change and as indicating the problem of one important group of creditors, table 92 records the changes between October 1, 1938, and May 1, 1939, of rental space in 16 important cities. Using Buffalo as an example, it is observed that new tenants more than compensated for the space surrended by concerns closing. Moreover, Buffalo gained by the intercity migration. Present tenants show a net expansion in space, also. On the other hand, there was more space lost to other buildings than gained through transfer of tenancy from other buildings.

The final column of table 92 shows a wide difference in the cities represented, ranging from a net expansion of almost 172,000 square feet in Philadelphia to almost 21,000 contraction in Detroit. While not all buildings are represented, it is believed by the reporting groups that the data are comparable. The space represents primarily office accommodations, a variety of financial, service, and light manufacturing space and retail stores.

TABLE 92.—*Fluctuations in tenancy (square feet of rental area changes between Oct. 1, 1938, and May 1, 1939)*

EXPANSION

City	New tenants (local)	New tenants from other cities	Tenants from other buildings	Expansion by present tenants	Total expansion
Akron	7,879	780	2,110	3,186	13,955
Buffalo	13,457	5,964	5,300	11,965	36,686
Cleveland	3,961	1,816	6,409	3,163	15,349
Chicago	121,342	20,205	238,216	177,868	557,631
Detroit	----------	----------	----------	----------	279,592
Duluth	2,081	2,426	1,043	1,649	7,199
Fort Worth	10,901	806	9,870	25,765	47,342
Indianapolis	9,138	646	22,742	9,903	42,429
Memphis	9,142	----------	634	3,606	13,382
Milwaukee	----------	375	636	2,042	3,035
Minneapolis	32,744	26,506	39,297	36,256	134,803
Omaha	6,189	3,740	9,118	9,930	28,977
Philadelphia	97,883	30,436	166,407	89,769	384,495
Portland	3,847	6,569	15,870	32,669	58,955
St. Louis	35,696	3,967	20,675	43,050	103,388
Spokane	9,261	----------	13,522	7,934	30,717

TABLE 92.—*Fluctuations in tenancy (square feet of rental area changes between Oct. 1, 1938, and May 1, 1939)*—Continued

CONTRACTION

City	Out of business	To other cities	To other buildings	By present tenants	Total contraction	Net expansion or contraction
Akron	6,011		4,185	2,061	12,257	[1] 1,689
Buffalo	10,563	724	10,606	5,571	27,464	[1] 9,222
Cleveland	6,771	566	3,022	2,258	12,617	[1] 2,732
Chicago	176,855		182,018	151,601	510,474	[1] 47,157
Detroit					300,360	[2] 20,768
Duluth	892	5,273	1,275	1,061	8,501	[2] 1,302
Fort Worth	5,565	2,500	12,171	6,916	27,155	[1] 20,187
Indianapolis	9,040	2,460	23,246	3,777	38,523	[1] 3,906
Memphis	10,175		2,765	10,789	23,711	[1] 10,329
Milwaukee			2,320		2,320	[1] 715
Minneapolis	25,908	1,291	41,690	22,358	91,247	[1] 43,557
Omaha	10,034	893	14,470	4,458	29,855	[2] 878
Philadelphia	71,270		89,940	51,436	212,646	[1] 171,849
Portland	11,217	2,726	25,246	23,450	62,639	[2] 3,684
St. Louis	12,385	3,911	18,639	23,219	58,152	[1] 45,236
Spokane	5,261	1,657	7,681	6,926	21,525	[1] 18,903

[1] Expansion. [2] Contraction.

CYCLES OF FAILURES

In a study of the duration of the cycle of business failures in the United States, Greenstein [12] estimates the typical length as 9.4 years. The period of 66 years included annual data from 1867 to 1932. The author carefully states that the period is not constant and warns that "seven instances of a cycle are hardly sufficient as a basis for forecasting."

It is apparent also that there are regional differences in failure cycles. For instance, the following applies to a comparison [13] of Colorado and national series for the period, 1900 through 1926: "The effect of the depression of 1907 was far greater upon the national series than upon Colorado failures; a comparison of the relative position of the curves in 1907 and 1908 would indicate that the panic's effect upon local failures was immediate but not prolonged. It is interesting to note that the highest point in Colorado failures about the middle of the period was in 1912 whereas the national series rose to a high point in 1915."

Following the collapse of 1920, numbers of failures increased rapidly, but whereas the peak of the national series was reached in early 1922, the maximum for Colorado was a year later. The lag of liquidation behind business crises is a common observation. In Austin,[14] Tex., it was found that proprietors continued depleting capital in the hope of survival and because other employment was difficult to obtain.

The relation of the business cycle to the life span of enterprises is discussed in another section.

[12] Benjamin Greenstein: "Periodogram Analysis with Special Application to Business Failures in the United States, 1867–1932." Econometrica, Vol. 3, No. 2, April 1935.

[13] John H. Cover: "Changes in Economic Welfare," Denver Business Review, vol. III, No. 1, January 1927.

[14] Solon Ayers: A Study of Mortality of Retail Grocery Stores in Austin, Tex., 1880–1932 (University of Texas Master's Thesis).

CHAPTER VI

BUSINESS MIGRATION

Shifts of industrial enterprise are continuous. With the rapid growth of a new area rich in natural resources and the influx of people, industry develops and branches of distant plants are established. This has been a frequent occurrence in our economic history. The steel and packing industries have moved westward in pursuit of new supplies of raw materials and fuels. The cement industry has diffused its manufacture as population has concentrated in widespread metropolitan communities.

With migrations of industry not only are employees of discontinuing concerns affected, in addition, the business lives of many kinds of suppliers are at stake, the purveyors of necessities to persons and to plants.

Unfortunately, the term, migration, has been employed in describing so many different kinds of movement that a false impression persists in the minds of many people that some areas of the country are being depleted of industries while others are booming with the accession.

At present the expression, industrial migration, is used with the following meanings: [1]

1. Actual movement of an industrial plant from one locality to another.
2. Movement of productive capacity without the actual movement of the original plant, the latter being retained while new plants are established in other territories. Branch plants illustrate this type of movement.
3. Development of new plants of a given industry in regions heretofore without such industry. These new plants may be under entirely different ownership from those established elsewhere.
4. One region may be experiencing a more rapid rate of growth than another.

Involved in the problem is the indefiniteness of delineation of regions. Differences between political and economic boundaries are further complicated by differences in the significance of areas to different industries. The New York manufacturing region includes territory in several States. In Minnesota, regions differ for the milling and the logging industries.

It is suggested by Mitchell that the following different kinds of inter-regional industrial displacements be recognized:

1. Unidirectional displacements are to be explained in terms of shifting regional advantage. Examples are, the "migration" of the cotton-textile industry from New England to the South Atlantic region, and the rising importance of Chicago as compared with Pittsburgh in the steel industry.
2. Dispersional displacements are those changes resulting in less concentration. They result in less regional emphasis than the unidirectional type. The unidirectional displacements do not tend to dissolve regional concentration; they merely give rise to new concentration. The opposite is true of dispersional displacements. This is the essence of decentralization.

[1] W. N. Mitchell: Trends in Industrial Location in Chicago Region Since 1920, University of Chicago Press, 1933.

3. Concentric displacement: This is the tendency for concerns in the same industry to gather in the same locality or region.

Dispersional movements within the single region might be termed "peripheral." Intraregional movements of the concentric type are less frequently observed than peripheral movements because centralization is more closely identified with early phases of urban government than with conditions characterising metropolitan areas today.

An analysis of the discontinuance of 845 business firms in Minneapolis, St. Paul, and Duluth [2] disclosed that some logging and lumber companies had transferred operations to the West and the South, but that the majority had closed entirely or shifted into other fields, such as road contracting. The closing of the important logging industry in Duluth was the only clear example of the migration of an entire industry.

In the case of the cotton-textile industry, movement to the South was selective.[3] It took from New England coarse- and medium-count fabrics but left overwhelming predominance in fine cotton goods and rayon mixtures. This resulted in complete specialization within these two divisions.

The increases of plant equipment in the South were due to specialization in cloth and yarn manufacture, a disparity in operating costs between the upper tier of Southern States and the deeper South, community desire for industries where agriculture was faltering.

That many closings in the textile industry were actual failures rather than migrations is indicated in an excerpt from a report of study in 1938 and 1939 by a Massachusetts commission: [4] "In cotton textiles 19 actual removals were traced, but cases are known in which Massachusetts concerns first established branch plants in other States, and then developed most or all of their operations in those plants. In other instances, capital recovered by liquidations was used to organize new cotton manufacturing corporations in other States. Losses by bankruptcies, liquidations, and curtailment of operations have been much heavier than by direct removals * * *. The survey made by the Commission disclosed only three actual removals of woolen and worsted mills to other States, so that most of the decrease in numbers of establishments between 1923 and 1935—71 altogether—was evidently due to bankruptcies, liquidations, and suspensions of business."

Of 79 removals in the boot-and-shoe industry, between January 1, 1930, and December 31, 1938, 46 establishments were relocated in New Hampshire, 25 in Maine, 3 in Rhode Island, 3 in New York, 1 in Pennsylvania, and 1 in Indiana. "A considerable number of * * * factories moved from one Massachusetts community to another."

In the same period 11 foundries and machine shops moved to other States, but 10 of these removals resulted from mergers or consolidations. In such instances migrations are contractions due to depression rather than shifts territorially, and are part of the closure picture.

[2] E. A. Heilman: Mortality of Business Firms in Minneapolis, St. Paul, and Duluth, 1926–30, University of Minnesota Press, 1933.

[3] Claudius Murchison: "Relocation of the Cotton Textile Plant," Proceedings of the Minnesota Conference on Unemployment Relief and Stabilization. University of Minnesota, Employment Stabilization Research Institute, 1932, pp. 71–77.

[4] The Commonwealth of Massachusetts, Final Report of the Commission on Interstate Cooperation, June 1939, pp. 14–19.

FACTORS IN INDUSTRIAL MOVEMENT

Shifts in industrial plants are made for a large number of reasons. The Massachusetts report [5] states that "ultimately, the matter depends largely upon comparative costs * * *" and suggests the following items: out-of-State competition, high wages, restrictive laws, labor difficulties, taxation, inefficient management, obsolescence of plant and equipment and technological changes. But many other factors are significant as well. A listing, with examples, may aid our identification:

1. *Raw materials.*—Seeking new sources of raw materials or areas with new materials accounts, in part, for a shift of paper manufacture to the South.

Within a few years the South has increased from a negligible production to 30 percent of Kraft output due to a new process making it possible to produce Kraft and certain types of pulp from slash, a fast-growing pine.[6]

An interesting sidelight on the development of southern manufacture is a resolution [7] approved by 80 percent of the "paperboard manufacturing industry" and addressed to the Reconstruction Finance Corporation. This resolution protests "against further public funds being loaned by the Reconstruction Finance Corporation or provided by any other public agency to promote the construction of any additional mills." Reference is made to the loan of $3,425,000 for construction of "a mill for the manufacture of newsprint paper * * * at Lufkin, Tex., which mill will on completion sufficiently demonstrate whether or not newsprint paper can be economically manufactured from southern timber * * *."

Some paint and varnish plants are being established in the South near sources of turpentine, resin, and tung oil.[8]

Loose-Wiles Biscuit Co. and General Mills, Inc., are decentralizing in part to insure processing against drought and crop failures in particular grain producing areas.[8]

With soil becoming a national concern, Goodrich foresees two general trends: Recoil eastward from the wind-devastated plains, and a drift northward out of the South.

2. *Markets.*—Doubtless with distribution costs looming as a major problem in industry many dispersional movements are aimed at establishing positions close to the demand for the product.

Paint manufacturers with national distribution operate factories in several parts of the country and have established a system of warehouses, each serving an area usually within a radius of about 500 miles. The tendency of retailers to carry small stocks and to aim for quick turn-over requires the manufacturer to be ready for prompt delivery.[9]

A few decades ago cement manufacture was centered in the Lehigh Valley of Pennsylvania. Today the Lehigh Portland Cement Co. operates in 10 States, the International Cement Corporation in 8, and the Alpha Portland Cement Co. in 7 States.[10]

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[5] Commonwealth of Massachusetts, op. cit.
[6] Business Week, Reports to Executives, No. 2, Industry on the Move, February 27, 1937.
[7] National Paper Board Association; signed by H. S. Adler, secretary, June 8, 1939, file R–3.
[8] Business Week, February 27, 1937, op. cit.
[9] Metropolitan Life Insurance Co., Policyholders Service Bureau, The Paint Industry: Plant Location Factors, 1936.
[10] Business Week, op. cit.

3. *Power and fuel.*—It has been suggested that cheap electric power might attract manufacturing to the countryside, but this possibility depends upon the extent to which power costs are a determining factor. It may become an important consideration when joined to a further development of railroad and highway transportation permitting extension to the periphery.[11]

Construction of large dams in the Tennessee Valley and in the West have already proved added inducements to establishment of new or additional plants.

Fuel is usually one of the largest expenses to the glass industry and, therefore, the manufacturer is very much influenced by the source of fuel supply in locating his plant. The glass industry was first located along the Atlantic coast, where wood was the chief fuel at that time. It followed the change in fuel to the coal fields of Pittsburgh, and later located near the gas and oil regions in western Pennsylvania. Either natural or artificial gas is said to be the ideal fuel in the glass industry because of its freedom from dirt and ashes, its uniform heat, its almost perfect combustion, and the ease with which its flame is applied and controlled.[12]

4. *Labor costs.*—Much has been printed and many statements made regarding the responsibility of labor costs in migrations. Usually no one factor is entirely responsible. Insofar as the South has an advantage to offer industry in low wages, that advantage probably will be short-lived. Development of industries in a community is automatically associated with a rise in prices and, therefore, in wages. Moreover, the national minimum wage law will tend to remove the South's advantage, by equalizing wage rates.

5. *Transportation.*—To save two-way freight charges on heavy steel cylinders and the pressure for lower selling costs has forced decentralization upon companies selling various gases for commercial uses. The Union Carbide & Carbon Co. operates 160 plants and the Air Reduction Co. 133 plants.[13]

The canning industry is another example. The California Packing Corporation has 75 plants in California. Similarly the companies supplying cans find it easier to ship sheet tin plate than finished cans. The American Can Co. operates 50 plants, as does the Continental Can Co.

6. *Efficient plant size.*—P. W. Litchfield, president of the Goodyear Tire & Rubber Co., referring to the company's purchase of a plant at Windsor, Vt., said recently: "Experience has taught us that a 5,000-tire plant running at full capacity with a standardized line can be just as efficient as one of 20,000, 30,000, or even 40,000 units with a fluctuating volume." T. G. Graham, vice president of the B. F. Goodrich Co., which is equipping a tire plant at Oaks, Pa., added: "Customers let it be known that we had better establish additional plants outside of Akron if we expect to enjoy our full share of their business." [13]

7. *Climate.*—The airplane industry is reputed to be moving to the Pacific coast in part in search of year-round flying weather.

8. *Negative factors.*—As summarized in a previous section of this study, some governmental agencies have offered inducements to

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[11] Daniel B. Creamer: Is Industry Decentralizing? University of Pennsylvania Press, 1935.

[12] Metropolitan Life Insurance Co., Policyholders Service Bureau, The Glass Industry: Plant Location Factors, 1934–35.

[13] Business Week, February 27, 1937, op. cit.

migration in the form of tax exemptions, aid in financing purchase of sites and equipment, and assurance of "passive labor conditions." These aids were directed at weak points in the armor of other jurisdictions.

For instance, movements of some plants out of Minnesota and Wisconsin were heralded as efforts to avoid taxes and regulatory statutes. Labor conditions and activities were widely quoted as reasons for some departures from New York and Ohio.[14]

In view of this type of competition it is interesting to observe some groups studying the probems of their own jurisdictions and establishing cooperative devices based upon the experience of their own concerns. It is sound, as a major step, to correct existing conditions.

As an example, a plan to aid existing industries and develop new industries for Danville, Ill. has been put into operation by the Danville Chamber of Commerce.[15] This plan provides for the construction of modern, low cost, daylight, efficiency factory buildings of standard construction.

After a study of the success and failure record of manufacturing concerns in Danville, certain facts were clearly established. (1) The majority of manufacturers have too much land and building. (2) The majority of manufacturers could efficiently occupy a standard building in place of a specially designed building. (3) The successful business must have a plant equal to or better than his competitors. (4) The cry for additional working capital was not the prime factor that spelled success or failure. The principal factor appeared to be business ability and orders. (5) Operating profit and losses, where they occurred were rarely correctly reported by small and medium-sized industries. Immediate cost and budget-control figures were absent in most concerns. (6) No special efforts were made by small and medium-sized industries to have financial statements that would be eligible for commercial or capital loans. (7) No sales, merchandising, operating, and financial assistance were available except possibly at professional rates. (8) No funds were available to buy lands or to build efficient factory buildings. (9) In the majority of cases very little funds were available for operations.

The solution proposed was the construction of modern factory buildings by the chamber of commerce.

These fine factories are acquired through payments like rent. No mortgage is assumed. For example, a factory with clear working space 40 by 115 feet on the office side, steel uprights, steel trusses, no posts, an adjoining space containing 814 square feet including boiler room, wash room, machinery room and office, all erected on a plot of ground large enough to provide for further expansion, which would be an addition to the length of the original unit making it 40 by 200 feet, doubling the office and running another wing on the opposite side 40 by 230 feet, can be acquired for approximately $10,000 with no down payment, but with rent of about $100 a month, and this will give the manufacturer title to the land and building in about 10 years and 7 months * * *.

The Danville Plan provides for a personnel made up of successful operating manufacturers. A manufacturers' and retailers' school is conducted on budget control and arranging financial statements so as to be eligible for commercial credit. The problems taken up are actual, and not academic. With a set-up of this kind, the civic-minded citizens of Danville developed an organization and employed a full-time secretary. They occupy their own building.

[14] Business Week, February 27, 1927, Op. cit.

[15] U. S. Department of Commerce, Bureau of Foreign and Domestic Commerce, Domestic Commerce Series, March 20, 1939, p. 166.

CONCENTRATION

Some industrial movements are centripetal, an assemblage in convenient centers.

In view of the abundant evidence of an ever-decreasing share of wage jobs located in the principal cities, it is of interest that the highest birth rates in both the durable and semidurable goods industries have been in the cities. The availability of loft space, workshops, abandoned factories and obsolete machinery, the presence of a large reservoir of workers with various skills, the existence of ample credit institutions, proximity to large concentrations of population and to transportation facilities tend to make the principal and satellite cities a favorable place for industrial incubation. This may be illustrated by the many small plants that started up in the silk and rayon business in Paterson, N. J., in 1929–33 at the very time the large plants were emigrating from the city.[16]

Birth and mortality rates calculated from unpublished data of the Census of Manufactures for durable and semidurable goods industries are presented in table 93.

TABLE 93.—*Vital statistics for 13 durable and 11 semidurable goods industries, 1929 and 1933*

[Based on unpublished data of the Census of Manufactures]

DURABLE-GOODS INDUSTRIES

Year	A [1]	B [2]	C [3]	D [4]	E [5]	F [6]	G [7]	Average	Total
Birth rate:									
1929	3.5	5.1	1.6	3.2	0.2	2.6	2.1	2.7	18.3
1933	1.7	.4	.5	1.1	.3	1.4	1.7	1.2	7.1
Mortality rate:									
1929	2.5	.9	1.1	.8	1.3	1.7	2.7	1.8	10.6
1933 [8]	(8)	(8)	(8)	(8)	(8)	(8)	(8)		

SEMIDURABLE GOODS INDUSTRY

Year	A [1]	B [2]	C [3]	D [4]	E [5]	F [6]	G [7]	Average	Total
Birth rate:									
1929	6.1	4.3	2.6	3.5	2.6	2.2	3.0	3.9	24.3
1933	8.3	8.2	2.6	2.1	1.3	4.4	4.3	5.1	31.2
Mortality rate:									
1929	6.1	6.8	2.8	1.9	1.1	1.0	1.1	2.9	20.8
1933	(8)	(8)	(8)	(8)	(8)	(8)	(8)		

[1] Principal cities of industrial areas.
[2] Large satellite cities in the industrial area.
[3] Remainder of the industrial area.
[4] A city of 100,000 or more inhabitants outside of an industrial area.
[5] Remainder of the county in which D is located.
[6] Important industrial county without a city as large as 100,000 inhabitants.
[7] Remainder of the United States.
[8] Not given.

PROSPECTUS

Since there is little prospect of a wide dispersion of economic activities and every likelihood of a continuation of the observed tendency toward its diffusion, manufacturing and other activities may be expected to develop in areas of moderate concentration and to spread out into suburbs and outlying sections of existing urban districts.[17]

[16] Daniel B. Creamer: "Is Industry Decentralizing?" University of Pennsylvania Press, 1935.
[17] Carter Goodrich, et al.: Migration and Economic Opportunity, University of Pennsylvania Press, 1936.

There is a tendency for industries to be less concentrated in certain favorite spots.[18] In most cases the dominance of the early center has disappeared due to its failure to keep pace with the growth of the same industry in other parts of the country. As example, Chicago fell from 35.6 percent of the national total in meat packing to 18.8 percent since 1899, although it has more than doubled its value of products. Also Philadelphia, in making carpets, and rugs, doubled the number of employees, but fell from 45.6 percent of the Nation's total to 27.8 percent.

Thus, we have three steps in the gradual evening out of manufacture:

1. Development of backward areas and decline of highly developed areas.
2. Development of rural sections and decline of urban.
3. Break-down of local concentration in historical centers of specific industries.

The advantages of these procedures are as follows:

1. Saving in freight hauling.
2. Less delay in shipping.
3. Less dependence of areas upon single types of manufacture or activity for livelihood.
4. Less violent depressions and less excited prosperities due to diversification of industry.

The relation of industrial movements to mortality are threefold. First, discontinuances frequently are reported as migrations. Second, desertion of one area and concentration upon another would directly affect the welfare of all concerns serving industries and employees. Finally, expansive and centrifugal movements must be accepted as normal elements of growth to be included in the planning and among the risks of business enterprise.

[18] Willard L. Thorp: The Changing Structure of Industry, in Recent Economic Changes in the United States, vol. 1, pp. 206–16, 1929.

CHAPTER VII

MANAGERIAL COMPETENCY AS A FACTOR IN BUSINESS MORTALITY

In the preceding chapters attention has been focused almost exclusively on the amount and character of business failure. We turn now to a discussion of the reasons. These may in general be grouped in two general classes; namely, failures due to errors in management and those due to lack of adequate protection by Government.

Management difficulties to which failures are attributed are as numerous as the problems of business. In individual proprietorships business difficulties are further complicated by the incursion of personal attributes and domestic and social relations.

From an analysis of life experience of retail concerns in small towns of Illinois [1], it is estimated that a dealer entering business has two chances out of three of lasting a year, an even chance of continuing through 2 years, and two chances out of five of surviving 3 years. Mortality among new establishments is much greater relatively than among those establishments that have succeeded in battling the disintegrating diseases of youth.

It may be generalized that much more foresight is required in the planning and conduct of a business than has been evinced in the establishment and guidance of most enterprises.

Perhaps in the future, with calorimeters, lie detectors, and mental-aptitude analyzers, the prospective manager may be cataloged as to success probability. Certainly at present predictions are precarious, and post mortems cursory and elementary.

From long-time studies of mortality rates, it would appear that there has been little change in the average life span of enterprises, and that at present entry into business is as inadequately planned, and control as inefficiently applied, as at any time in the last 80 years.

TRAINING AND EXPERIENCE

In instances failing proprietors were found to have the technical training required for the particular business, but no business experience; in other cases, to have had previous general business employment alone, which required the engagement of technical assistants beyond the capacity of the firm to support. This is illustrated in the case analysis of liquidating retail druggists in St. Louis [2] Twenty-five of the 30 druggists studied probably were qualified technically through training and retail drugstore sales experience; 23 lacked previous

[1] Paul D. Converse: Business Mortality of Illinois Retail Stores from 1925 to 1930, University of Illinois Bull. No. 41.

[2] U. S. Department of Commerce, Bureau of Foreign and Domestic Commerce, Domestic Commerce Series No. 59, Causes of Failure Among Drug Stores, 1932.

management experience adequate to the direction of an enterprise. Five had neither business nor technical training nor experience.

Analysis of factors influential in the bankruptcy of 397 Chicago retail concerns indicates that about one-half of the individual proprietors failed because of discernible errors in management.[3] Seven percent of this group were so lacking in background experience as to leave native aptitude as the only possible element in management success. An additional 6 percent showed general incompetence; since this category has an arbitrary standard of judgment, it was used only when recurrent mismanagement appeared in various phases of business. Moreover, inexperience was a contributory factor in more than 6 percent of the cases having other primary causes, while general incompetence appeared in a similar proportion of the cases with principal factors assigned elsewhere. In fact, inexperience and general incompetence affected more than 27 percent of all bankrupts.

Twenty-six percent of retail failures in the period 1890–1931 were due to incompetence or inexperience, according to the estimate of Dun and Bradstreet.[4]

As stated by Thorp,[5] "It is not difficult to enter into retailing. The public does not regard it as a type of activity calling for any high degree of technical knowledge. We all remember how successfully we played with toy cash registers as children and feel that successful merchandising needs only an average amount of intelligence and common sense. We meet merchants daily, and they do not impress us as being supermen.

"The result of this situation is a continual flow of hopeful and enthusiastic individuals into retailing, replacing another group of sadder and, we hope, wiser men."

In commenting upon results of retail mortality experience in Colorado,[6] Hallas estimates—

> * * * in all likelihood much of the failure rate in the retail trades may be attributed to inadequate foreknowledge of what the business entered into really requires in the way of capital, markets, and managements.

And Nystrom concludes—[7]

> No lesson is drawn from the accumulated experience of the vast number of failures that have taken place in the past. For the most part the system by which elimination takes place is such as to preclude the outside public from gaining from the experiences of others.

In estimating the relative importance of training and experience in the drug and grocery trades, Boer [8] points out that the drug trade has "educational requirements for dispersing prescriptions," whereas, no "special knowledge of merchandise is believed to be required in the operation of a grocery store, and it is a trade that attracts the unthinking on the basis that 'everyone must eat' and therefore the business is sure to be successful."

Forty percent of the failing grocery proprietors included in Boer's study had no previous experience which might be of any possible value

[3] John H. Cover: Business and Personal Failure and Readjustment in Chicago. University of Chicago August 1933.
[4] Quoted by Paul H. Nystrom, Opportunities for the Improvement of Retail Management, Journal of Marketing, April 1936.
[5] In an address "Trend of Failures in the Distribution Field," quoted in a Bureau of Foreign and Domestic Commerce release, Business Information Section, October 1938.
[6] E. T. Hallas: "Mortality of Retail Stores in Chicago," University of Denver, 1936.
[7] Paul H. Nystrom: "The Economics of Retailing" 1919, p. 325.
[8] A. E. Boer: "Mortality Costs in Retail Trades," Journal of Marketing, Vol. II, No. 1, July 1937, pp. 52–60.

in the new enterprise. In the shoe trade the proportion of inexperienced managers was 29 percent, in the hardware field, 22 percent, and in the drug trade, 16 percent.

Of the Poughkeepsie proprietors,[9] more than 50 percent were inexperienced in the field of their endeavor, while an additional 12 percent had had no previous employment whatever.

It was the observation of Vaile [10] that more than one-half of the persons entering the grocery field in 1930 were without employment and "had to do something." Fifty percent of the new proprietors had no previous grocery experience, either in the retail or wholesale field.

McGarry [11] selected a group of discontinuing Buffalo retail proprietors for questioning as to previous occupation and reasons for entering the particular trades. Of 45 grocers without previous merchandising experience, 12 had been laborers; of 61 with some trade experience, 26 had been in the confection, 11 in the meat, field. Three principal reasons were offered for entry into proprietorships: the desire for the independence associated with managing one's own enterprise; the hope for a steady, increasing income; the opportunity for supplementary, regular income through establishment of a small outlet as a side issue with members of the family operating it.

Of 322 Poughkeepsie retailers whose background was determined, almost 38 percent recorded experience which was related to the field of their proprietorship: grocery, meat, saloon, confectionery, or tobacco. Thirty-nine percent had been laborers, and almost 12 percent had had no previous occupation.

The flux of occupations is vividly illustrated in the following summary of Pittsburgh [12] cases:

Related experience.—Of 77 grocers, 48 had been grocery sales clerks; 8 meat sales clerks; 6 wholesale salesmen; 5 miscellaneous salesmen; 4 hucksters. Of 49 hardware proprietors, 37 had been hardware sales clerks; 4 wholesale salesmen; 4 contractors. Of 62 drug store proprietors, 52 had been drug sales clerks; 5 miscellaneous salesmen. Of 37 shoe store proprietors, 28 had been shoe store sales clerks; 8 wholesale salesmen.

Unrelated experience.—Of 51 grocery proprietors, 21 had been laborers; 8 farmers; 6 office clerks; 5 truck drivers. Of 14 hardware proprietors, 2 had been laborers; 2 carpenters; 2 engineers. Of 12 drug-store proprietors, 2 had been laborers; 2 office clerks. Of 15 shoe-store proprietors, 12 had been laborers.

The "side-issue," "hole-in-the-wall," enterprise is of major significance in the problem of retail mortality. It may be an increasing phenomenon in some fields, including groceries, beverage dispensaries, and counter eating places. Frequently, these stores and service establishments are seasonal in their operation; in many instances, they are used to tide a family over periods of unemployment. A contrast of "home" and separate establishments for five fields and for two periods is presented in table 94.

[9] R. G. Hutchinson and A. R. and Mabel Newcomer; Op. cit.
[10] R. S. Vaile: "Grocery Retailing with Special Reference to the Effects of Competition," Studies in Economics and Business, No. 1, University of Minnesota Press.
[11] Edmond D. McGarry: "Mortality in Retail Trade," University of Buffalo, 1930.
[12] A. E. Boer: Op. cit.

TABLE 94.—*Comparison of number of Poughkeepsie business concerns in homes and in separate buildings*

Kind of business	Total number of concerns	Home	Percent separate	Total
1873-76				
Grocery store	94	54.3	45.7	100
Meat market	35	17.1	82.9	100
Saloon	81	86.4	13.6	100
Confectionery store	19	57.9	42.1	100
Cigar store	43	41.9	58.1	100
1923-26				
Grocery store	329	[1] 59.9	40.1	100
Meat market	82	18.3	81.7	100
Saloon	27	59.3	40.7	100
Confectionery store	79	51.9	48.1	100
Cigar store	38	18.4	81.6	100

[1] When chain stores are omitted, 66 percent.

Since these home stores are so frequently temporary by intent as well as in fact, and subject to discontinuance and reestablishment, they present problems of competition to other enterprises, and of estimating to the student of business population.

In summary, several points may be made. While factual information refers principally to the retail and service fields, it is believed that similar circumstances apply, though perhaps to a lesser extent, to other business fields. It is apparent that optimism exceeds understanding in the cases of possibly two-thirds of our new proprietors. There exists no adequate device for tempering the desire for independence in business with the knowledge of the attributes necessary to assure continued enjoyment of that independence.

AGE OF MANAGER

The physical age of a proprietor, particularly at the time of establishing an enterprise, may not only be a general index of the energy with which he is likely to promote his business, but, in addition, a warning of underlying causes leading to his entry into business.

Recording the ages of failing proprietors in Pittsburgh [13] for the period 1925–34, Boer classified the ages at entry into two periods: those entering prior to 1920, and those inaugurating businesses in 1920 or later. It was found that in the retail grocery, drug, hardware and shoe trades the age of entry was relatively greater in the period beginning in 1920.

While a possible element, the early elimination of older proprietors in the first period is not sufficient to account for this shift, particularly to the extent that the Chicago [14] bankruptcy experience is applicable. The age range of the most frequent failures in Chicago was from 36 to 40 years, with the 5-year age periods immediately above and below heavily represented. Very small proportions of the total occurred at ages below 26 and above 55. While individual proprietors and managers of corporations were recorded principally in the age group

[13] A. E. Boer: Op. cit.
[14] John H. Cover: Op. cit.

36 to 40, the concentration of partnership failures was within the range of 26 to 35.

Compared with the range of years available for business activity, and the frequency of age groups in the human population, it appears that turn-over is highest in the ages centered at about 35 years.

Neglect of business was the principal factor attributable to 3 percent of the Chicago [15] bankruptcies. The interests diverting attention to the proprietor ranged from other business or professional responsibilities—applying to 9 percent of all cases—to the attractions of the dog races.

PERSONALITY

As important as unmeasurable are the personal characteristics of the proprietor and his staff. Two percent of the retail bankruptcies in Chicago [16] were attributed primarily to this factor. This group included illiterate persons whose chances of success even in the neighborhoods of lowest standards of intelligence seemed exceedingly small. In other instances repugnant, or offensive, personality seemed to be a large factor in failure as gaged by the interviewer's estimate and by inquiry among creditors, customers, employees, and neighbors.

A study of food outlets in Pittsburgh [17] disclosed that one-fifth of the proprietors permitted attendants with soiled and unsightly clothing to serve customers, an important neglect in personal appearance frequently associated with other forms of carelessness in business management.

From the same source many other attributes are suggested as limitations upon business success, some within personal control: absence of refrigeration, lack of protection of meat and other merchandise, careless and unsanitary handling of commodities, wrapping meat in newspapers, unclean store interiors. In 38 percent of the outlets observed, no greeting or expression of appreciation for patronage was extended to customers.

ACCOUNTING RECORDS

It is difficult to conceive of business decisions without accounting and statistical records as bases for judgment; even the hole-in-the-wall store needs information regarding inventory turn-over and expenses. The extent to which records are neglected, even recognizing the demands upon the time of the lone proprietor-clerk, is amazing. A Pittsburgh retailer simply counts his cash each night; he explained, "If there comes a time when the cash drawer is empty, then I'm out of business."

An appraisal of the adequacy of records of New Jersey and Boston bankrupts,[18] based upon estimated needs of the individual concerns, disclosed that almost one-third kept no records, and that less than one-fourth kept adequate records.

In table 95 the data are presented in detail.

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[15] John H. Cover: Op cit.
[16] John H. Cover: Op. cit.
[17] John H. Cover: Neighborhood Distribution and Consumption of Meat in Pittsburgh, University of Chicago Press, 1932.
[18] William O. Douglas: "Some Functional Aspects of Bankruptcy," Yale Law Journal, vol. XLI, No. 3, January 1932, pp. 329–364.

TABLE 95.—*Accounting records of New Jersey and Boston bankrupt firms*

NEW JERSEY

Business	Number of cases	Adequate	Inadequate	None	Insufficient data
		Percent	*Percent*	*Percent*	*Percent*
Retailers	231	27.4	36.9	24.7	11
Proprietors (miscellaneous)	33	27.2	12.6	30.1	30.1
Realtors	29	17.3	27.4	38.0	17.3
Wholesalers	12	75.0	.0	.0	25.0
Manufacturers	26	61.5	26.9	.0	11.6
Contractors	99	19.2	39.4	29.4	12.0
Professional people	16	.0	12.5	87.5	.0
Total	446	27.2	30.9	28.8	13.1

BOSTON

Business	Number of cases	Adequate	Inadequate	None	Insufficient data
Retailers	179	17	47	33	3
Proprietors (miscellaneous)	32	25	32	34	9
Realtors	33	15	15	51	19
Wholesalers	34	38	40	19	3
Manufacturers	34	50	26	21	3
Contractors	103	18	29	48	5
Professional people	7	29	28	43	0
Total	422	22	37	36	5

COMPARATIVE SUMMARY

	Adequate		Inadequate		None		Insufficient data	
	Number of cases	Percent	Number of cases	Percent	Number of cases	Percent	Number of cases	Percent
New Jersey	121	27.2	138	30.9	128	28.8	59	13.1
Boston	95	22.0	154	37.0	153	36.0	20	5.0
Combined	216	24.8	292	33.5	281	32.4	79	9.3

A similar condition existed among Chicago bankrupts. Of 708 firms studied in detail, one-third kept no books and another third kept inadequate systems of receipts and expenditures. Of the 103 manufacturing concerns included, 72 had adequate record systems; 54 of these were corporations. Only 27 percent of the 494 retail merchants had adequate accounting systems.

Records of failing drug stores in St. Louis [19] would not have revealed at any time the status of the business. Only 2 of the 30 enterprises studied had ever attempted to prepare statements of profit and loss and balance sheets. Most of the proprietors took action.

Though neglect may account for the absence of records in some cases, and the pressure of long hours and of fatigue in others, it is apparent that the basic difficulty is the complete ignorance of the elements of managerial control.

[19] See U. S. Dept. of Commerce, Domestic Commerce Series No. 59.

CHAPTER VIII

ADEQUACY OF CAPITAL

Most analyses of business failures record inadequate capital as one of the most important causal factors. Again, we are dealing with a term defying definition, and with a complex series of interrelated elements. If a going concern, successful in its history of earnings, suffers from lack of capital, the probable fault lies with a phase of management rather than with the investment or credit market. If an enterprise is established on a "shoestring," it may logically be classified as lacking economic reason for existence.

Current researches promise to give us bases for the identification of optimum firms in certain fields and stages of business. Standards of measurement, including proportions of the most economical combination of constituent factors would aid materially in determining the need, in a particular field, for new enterprises and for expansion of existing concerns. But, in addition, there are always fortuitous events demanding alert management to take advantage of market conditions and to fortify against recessions.

In any event, capital is a factor of production and a tool of management. And its need varies with the functions the enterprise performs, the stage of development of the firm, the crises to be tided over, and the opportunities for expansion of service and for acquiring of the sinews of operation.

FRAUD

Douglas [1] reported 16 cases of fraud in 118 bankruptcies analyzed. Of 38 cases with previous failures within the preceding 6 years, 3 were fraudulent, and of the 20 cases in which a discharge had been granted within the preceding 6 years, there were 3 tinged with fraud.

A case in point is quoted:

> No. 0311 was the case of a retail shoe dealer tinged with fraud throughout. In the same line of business he failed twice before—1913 and 1917—each time making an assignment for the benefit of creditors. A few months before bankruptcy he had given a financial statement showing $8,000 in stock and annual sales of $31,000. On examination he gave his sales as $18,000. Shortly after giving the above statement his stock was sold at public auction and purchased by his son for $1,200. It seemed fairly clear that he sold most of his stock at any price and gave the money to his son so as to buy back the business. It further appeared that during the past few years he had taken money from the business to purchase real estate in his wife's name. His total liabilities were $9,800, most of which was owed wholesalers. His assets were the $1,200 of stock.

Frequently, a review of a business case history suggests irregular practices, whereas the proprietor at the time of an emergency probably merely acted to stay failure and with honest intentions. In the surroundings of the bankruptcy procedure in Chicago,[2] the "atmosphere is surcharged with emotion, and accusations of fraudulent intent are made in a majority of cases." Speculation, particularly, borders upon

[1] William O. Douglas: Op. cit.
[2] John H. Cover: "Business and Personal Failure and Readjustment in Chicago, 1933."

the fraudulent in the use of funds, which proprietors tend to regard as their personal property.

In general, liquidations induced with the object of fraudulent gain are a small proportion of discontinuances. On occasion, a crisis brings a desperate effort at adjustment, resulting in an apparent misappropriation of property.

INVESTMENT

An approach to an estimate of capital investment is the net worth of firms based upon credit ratings. As reported in the section of this report on business life span, table 38, page 31, more than 65 percent of all enterprises in three Minnesota [3] cities had a net worth of $2,000 or less, or the investment was not ascertainable. Attention is called to a bias in individual proprietorships and partnerships with ratings under $5,000 since private properties are usually included in the "estimated pecuniary strength"; consequently, the recorded figures of at least two-thirds of the enterprises are probably in excess of actual business investment.

Manufacturing firms constituted only 12.3 percent of the total number of establishments, but this proportion is greater than for the United States [4] as a whole, in which manufacturing establishments account for only 8 percent of all enterprises. In the Minnesota communities almost 51 percent of the manufacturers had a net worth of less than $2,000 or an uncertain amount of investment. Machinery and equipment concerns and printing establishments account for about one-half of this group.

A smaller proportion of manufacturing than of wholesaling enterprises are found in the higher investment groups. Of the wholesaling firms, 7.5 percent are rated at more than $500,000, 24.3 percent at more than $75,000, and 54 percent at more than $10,000. But almost 39 percent are found in the group with less than $2,000. While wholesaling establishments account for about 9 percent of the total of enterprises in the United States, they constitute 7.7 percent in the Minnesota cities.

It is apparent that most business in this area is "small" business, and that a standard of judgment as to essential capital investment might be quite different in the industrial Northeast.

Studying the circumstances under which 270 establishments failed in the Minnesota communities, it was estimated that lack of capital was of prime importance in 116 cases, as compared with 133 cases charged, in general, to "management difficulties."

Throughout most of the period during which Bradstreet assigned causes of failure, lack of capital ranked first. In 1931 and 1932 Bradstreet [5] attributed 31.5 and 30.2 percent of the failures to lack of capital, and for the period 1890 to 1931 assigned this cause on an average to 31 percent of failures.[6] Subsequently, these published estimates were discontinued.

In an analysis of the difficulties of Chicago [7] retail bankrupts, while one-half of the liquidations were attributed to managerial limitations, including failure to control capital, only 6.5 percent of the bankrupt-

[3] E. A. Heilman: Op. cit.
[4] U. S. Bureau of the Census, Statistical Abstract of the United States, 1938.
[5] Dun & Bradstreet, Bradstreet's Failure Statistics for 1938, Bradstreet Press, N. Y.
[6] Quoted by Paul H. Nystrom: "Opportunities for the Improvement of Retail Management," Journal of Marketing, April 1936.
[7] John H. Cover: Op. cit.

cies were traced primarily to capital problems; of these, almost one-half were assigned to the category of inadequate capital at organization. However, it is probable that many discontinuances within the first and second year of business life are related, at least in part, to too small capital; the bankruptcy process is used as a method of dissolution by only about 5 percent of discontinuing manufacturing firms and 2 percent of retailing establishments.[8]

It is clear that most of the Chicago [9] firms were, in the year preceding bankruptcy, living principally upon short-term loans or merchandise credit, or both, and were, therefore, not economic enterprises. Approximately one-fourth of the retail drug stores and one-eighth of the women's clothing concerns had less temporary than permanent capital invested.

Almost 85 percent of the failing Chicago [9] concerns had original capital not exceeding $10,000, and 67 percent had $5,000 or less. The capitalization of two-thirds of the manufacturing firms did not exceed $10,000, and only 14 percent exceeded $50,000. Less than 5 percent of the retail enterprises had original capital exceeding $20,000.

A study of failing retail meat stores in Chicago [10] disclosed for the period 1920 through 1930 a maximum average initial investment of $2,386, and a minimum of $1,543. The former was in 1920, and the latter in 1927. But the rating service found that in 1930 less than one-half of the new stores had an ascertainable capital investment as compared with three-fourths in 1921.

The relation of capital investment to survival is represented in table 96.

TABLE 96.—*Percentage of Chicago meat stores in each capital-rating group and percentage continuing in business over 5 years*

Capital rating	Percentage to total number of stores			Percentage continuing more than 5 years		Average life in years, stores in business in 1920
	In business in 1920	Entering		Stores		
		1921-26	1921-30	In business in 1920	Entering 1921-26	
Above $10,000	3.8	1.1	0.9	43.4	31.8	5.9
$5,000 to $10,000	4.1	2.3	1.9	33.7	31.0	4.8
$3,000 to $5,000	6.7	6.1	4.9	32.3	25.7	4.5
$2,000 to $3,000	6.0	9.0	8.0	28.7	25.9	4.3
$1,000 to $2,000	9.3	13.3	11.6	30.9	24.6	4.2
$500 to $1,000	12.7	12.9	11.9	26.6	25.3	3.7
Under $500	35.8	19.5	17.9	17.8	20.2	2.7
No rating	21.6	35.8	42.9	23.4	22.0	3.5
All stores	100.0	100.0	100.0	24.6	23.3	3.6

The United States Department of Commerce has made a number of studies of mortality in various cities. In each instance it was found that an important condition was an insufficiency of capital to meet emergency conditions, or an inability of the manager to operate effectively with the capital available.

In an analysis of bankruptcies in Boston and contiguous territory, the Department [11] reports that approximately 48 percent of the bank-

[8] Dun & Bradstreet: offered in Willard Thorp's testimony, hearings before the Temporary National Economic Committee, pt. 1, pp. 129-131.
[9] John H. Cover: Op. cit.
[10] Howard C. Greer: "Business Mortality Among Retail Meat Stores in Chicago between 1920 and 1933," Journal of Business, University of Chicago, vol. IX, July 1936.
[11] U. S. Department of Commerce, Bureau of Foreign and Domestic Commerce, Domestic Commerce Series No. 69, "Causes of Commercial Bankruptcies, 1932."

rupts attributed their failure to insufficient capital, while 33 percent of the creditors involved agreed with this conclusion. There was closer agreement of debtors and creditors on this point in the manufacturing field than elsewhere.

A survey of grocery-store failures in Lincoln, Nebr.,[12] disclosed that 37 of 50 failing concerns had investment in stock and fixtures of less than $2,000. Bankruptcy records in Philadelphia [13] for the period 1922 to 1936 indicated that 10 percent of all individuals had little or no capital upon establishing an enterprise.

Many Knoxville grocers [14] had entered business with little or no capital and were forced to rely upon loans and credit.

Illinois [15] experience indicated that trades requiring the greater amount of capital for entry had longer life spans, on the average; this fact favored survival of drug and hardware establishments, as compared with other retail groups. It was suggested that the survival advantage of the larger Poughkeepsie [16] concerns might be due in part to more careful study of conditions before investing large capital amounts. The same conclusion, in part, was reached in the Pittsburgh [17] study.

In the cities studied by Vaile,[18] from 55 to 70 percent of the independent stores had investments not exceeding $1,000. In 1928, 84 percent of the liquidating establishments had a rating of $1,000 or less.

In the automobile industry, it was found [19] that in almost every year the firm with the highest return was near the median size of invested capital, that there was no relation between the size of firms and earning stability, and that high and stable earnings were related.

Rodkey [20] found a direct relation between survival of Michigan banks and the size of capital and surplus, ranging from a failure of 24.6 percent for the group with $25,000 or less to 16.67 percent for those exceeding $500,000.

Instances of the impairment of capital are provided by the Beacon Falls Rubber Shoe Co. and the Columbia Gramophone Manufacturing Co.[21]

In the Beacon Falls case, the ratio of current assets to current liabilities stood at 289 in 1918; in 1919 it was 259; in 1920, 287; in 1921, the year a creditor's committee took charge, at 120. The ratio of quick assets to current liabilities proceeded as follows: 1918, 197; 1919, 160; 1920, 196; 1921, 71. The net worth to debt ratio declined for the given years: 425, 296, 369, 88. The trends of current liabilities and of net worth indicate the dependence of the company upon creditors. Calling the 1918 value of current liabilities 100 percent, the indexes for the following years were 107 percent for 1919, 148 percent for 1920, and 564 percent for 1921. Concurrently, the net-

[12] Harold G. Avery: "Some Aspects of Grocery Store Failures," Nebraska Studies in Business, No. 14, Committee on Business Research, University of Nebraska, 1926.

[13] William Lowry and Christian L. Swartz: "Causes of Philadelphia Commercial Bankruptcies in the Last 14 Years," Philadelphia Chamber of Commerce, 1937.

[14] John N. Rebori: "Business Mortality of Retail Grocery Stores in Knoxville, Tenn., 1924–35," University of Tennessee Thesis, 1937.

[15] Paul D. Converse: Business Mortality of Illinois Retail Stores from 1925 to 1930, University of Illinois, Bureau of Business Research, Bull. 41.

[16] R. G. Hutchinson and A. R. and Mabel Newcomer: Op. cit.

[17] A. E. Boer: "Mortality Costs in Retail Trades," Journal of Marketing; vol. II, No. 1, July 1937, pp. 52–60.

[18] R. S. Vaile: "Grocery Retailing With Special Reference to the Effects of Competition," Studies in Economics and Business, No. 1, University of Minnesota Press.

[19] Ralph C. Epstein: "Profits and Size of Firms in the Auto Industry," American Economic Review, vol. XX, No. 4, December 1931.

[20] Robert G. Rodkey: State Bank Failures in Michigan, Michigan Business Studies, vol. VII, No. 2, University of Michigan, 1935.

[21] Paul J. Fitzpatrick: "Symptoms of Industrial Failures as Revealed by an Analysis of the Financial Statements of the Failed Companies, 1920–29"; Catholic University, Washington, D. C.

worth index rose from 100 percent in 1918 to 103 percent in 1919, and to 128 percent in 1920, but dropped to 117 percent in 1921. The rise of the inventory index from 100 percent in 1918 to 297 percent in 1921 discloses one use of the capital.

The Columbia Co. had in 1915 a ratio of current assets to current liabilities of 333. This proportion fell below the 2 to 1 relationship in 1921 to 138, and in the following year to 84. The ratio of quick assets to current liabilities stood at 199 in 1915; by 1920 it had fallen to 71, by 1921 to 54, and by 1922 to 41. With large orders on hand in 1919, and prospects for increased demand bright, the company purchased land and erected plants at Bridgeport, Baltimore, and Toronto, at an aggregate cost of $5,000,000. It was soon apparent that the demand was only temporary, probably the result of a forced curtailment of production in the war years and the carry-over of unfilled consumer purchases into the early post-war years.

SOURCE OF CAPITAL

Since mortality experience in the manufacturing field still awaits adequate study, and since the usual method of liquidation or rehabilitation of the corporation is through receivership, few factual data are available relative to source of capital. However, it is the usual procedure to finance corporations through stock issues and to reinvest a portion of earnings after the concern becomes a profitable enterprise.

A recent report of the silk industry in Paterson,[22] N. J., gives significant information regarding the financing of the small units represented. The investment of operators of the 100 shops was small. Fifty-five concerns opened before 1926, and of the 170 full or part proprietorships, information was obtained from 165 regarding initial outlays. The median amount of their investment was $808 per individual. The new establishments from 1926 to 1936 represented 53 full or part proprietorships; 5 received machinery as gifts, so that amounts of outlay were not obtainable. The median investment for the remaining 48 was $611. The initial investment record is summarized in table 97.

TABLE 97.—*Individual investment of operations in year of first entry into business, 1904–36* [1]

Individual investment	1904–36			1904–25			1926–36		
	Total	Sole operator	Partner or shareholder	Total	Sole operator	Partner or shareholder	Total	Sole operator	Partner or shareholder
Total [2]	213	51	162	165	16	149	48	35	13
$500 or under	57	18	39	35	2	33	22	16	6
$501 to $1,000	86	11	75	77	3	74	9	8	1
$1,001 to $1,500	14	9	5	6	2	4	8	7	1
$1,501 to $2,000	32	5	27	27	4	23	5	1	4
$2,001 to $3,000	12	2	10	12	2	10	0	0	0
$3,001 to $4,000	5	3	2	4	2	2	1	1	0
$4,001 to $5,000	6	3	3	4	1	3	2	2	0
$5,001 to $6,000	1	0	1	0	0	0	1	0	1
Median investment	788	841	780	808			611		

[1] Data obtained in National Research Project Field Survey: Schedule for shops having 20 looms or less.
[2] Includes operators interviewed in 1936 and others who were associated with them in business when they first became broad-silk operators. Excludes 10 operators not reporting initial investments. Represents 54 shops for 1904–25 and 41 for 1926–36.

[22] James E. Wood "Employment Experience of Paterson Broad-Silk Workers, 1926–36," W. P. A., National Research Project, Rept. No. L-3, 1939.

One of the burdens which enterprises frequently must support as the result of inadequate initial capital is the purchase of equipment and fixtures on credit. The Paterson experience is in point.

In 68 of the original 100 entries, machinery was purchased on time. The usual down payment was 50 percent of the purchase price.

Savings from wages was the most common source of funds for initial investments. Other sources included insurance benefits, dowries, the soldier's bonus, and loans.

One-half of the 100 shops experienced dissolution; of the 50 escaping, 31 had opened within the previous 5 years. The 50 dissolving within the period studied accounted for 76 closings, 12 having discontinued twice; 5, three times; and 1, five times.

Failures in this declining industry were not relative to the size of plant. Of the 49 shops closing in 1936, 23, or 47 percent, had 20 or fewer looms; in the same year, 203 of the total of 390 plants, or 52.2 percent, had 20 or fewer looms. While approximately 40 percent of the plants had from 21 to 60 looms, 37 percent of the failures were in this size group. Five percent of existing shops had loomage between 61 and 100, but the closures in this group reached 10 percent. The remaining plants, less than 3 percent, with loomage exceeding 100, accounted for 6 percent of the closures.

Shoe manufacturing [23] is another industry in which large capital is not required to establish an enterprise, due to the small-scale nature of production, particularly of women's shoes; and to the practice of renting manufacturing machinery. This practice creates other types of problems, of course, in operating costs and in excessive competition.

Through analysis of liabilities of Chicago [24] bankrupts, a picture is available of the inadequacy of proprietor investment and of the source of working funds and credit. Borrowings safeguarded by collateral reach their highest proportion in the manufacturing field, almost 64 percent of total indebtedness. Only one-fourth of the loans to retailers was secured, and, of this group, drug stores and women's clothing establishments protected only 13 percent of indebtedness. The extent to which landlords and wholesalers financed unsuccessful enterprise is evident in table 98 which summarizes sources by various business groups. The small proportion of businessmen resorting to loan and finance companies is in contrast to the professional and employee groups; in the latter cases 26 percent of liabilities were owed to loan companies.[25]

Of capital available upon entering business, failing Philadelphia [26] grocers provided 66 percent themselves. Probably the inadequacy of this original investment is related to the extent of borrowing at high rates subsequently, in instances ranging from 18 to 35 percent. Supporting this inference is the high turn-over of enterprises within the first 2 years, 7 percent of the initial capital was obtained from relatives and friends, and 5 percent from merchandise creditors, while fixtures purchased on installments accounted for almost 19 percent.

[23] Horace B. Davis: "Business Mortality: The Shoe Manufacturing Industry," Harvard Business Review, Spring, 1939.

[24] John H. Cover: "Business and Personal Failure and Readjustment in Chicago," University of Chicago, August 1933.

[25] John H. Cover. "Consumer Credit and Individual Bankruptcy," Annals American Academy Political and Social Science, March 1938, pp. 86–92.

[26] U. S. Department of Commerce, Bureau of Foreign and Domestic Commerce Trade Information Bulletin No. 700. "Credit Extension and Causes of Failure Among Philadelphia Grocers."

TABLE 98.—*Percentage of amounts of total liabilities in particular debt categories—individual proprietors*

Business groups	Percentage of total amounts in respective sources				
	Total liabilities in dollars	Secured by collateral	Loan and finance companies	Banks	Installment goods
Groceries	558,489	46.00	1.77	1.53	
Total food	883,180	38.40	1.56	1.89	
Restaurants	495,493	21.72	.08	.86	0.06
Drugs	439,527	13.45	.25	1.31	1.02
Total men's clothing	272,102	14.85	1.03	6.95	
Total women's clothing	753,253	13.42	.32	1.68	
Total clothing	1,362,814	20.28	.49	2.56	
Total retail	5,749,919	25.12	.94	2.46	11
Total wholesale	378,911	30.41	.35	7.62	
Total manufacturing	1,920,073	63.76	.82	.65	
Agriculture	21,540	28.73	3.97	8.96	1.09
Miscellaneous trade and services	1,055,821	40.48	1.16	2.08	.36
Real estate	8,440,240	76.73	1.03	3.25	.003
Total	17,566,504	55.18	.97	2.74	.06

Business groups	Percentage of total amounts in respective sources				
	Retailers	Professional services	Individual persons	Rent	Wholesalers
Groceries	0.01	0.44	3.16	9.53	26.49
Total food	.22	.62	5.21	10.53	30.39
Restaurants	.51	.54	7.14	29.23	32.66
Drugs	.07	.15	4.92	31.01	34.66
Total men's clothing	.12	.76	5.62	9.88	50.84
Total women's clothing	.07	.17	6.32	3.37	60.38
Total clothing	.08	.29	6.41	4.21	55.16
Total retail	.40	.40	7.71	11.21	41.53
Total wholesale		.43	6.69	1.58	51.36
Total manufacturing	.31	.23	2.71	2.06	22.23
Agriculture	8.44	.52	2.90		23.14
Miscellaneous trade and services	1.44	.77	9.02	17.60	12.10
Real estate	.22	.28	4.13	.31	7.22
Total	.37	.35	5.49	5.13	21.36

Twenty-one percent of New Jersey [27] bankrupt establishments borrowed from loan or finance companies. The largest proportion was recorded for painting contractors, and the second largest for retail jewelers. While only 15 percent of the retail food group borrowed from this source, one establishment had 12 creditors in this group.

With the capital of Boston bankrupts averaging $4,215 and those of New Jersey, $9,030, the Bostonian, on an average, provided 77.5 percent of the total from his own resources, the New Jersey [28] proprietor only 18.4 percent. Comparisons are made in table 99.

Louisville,[29] Ky., liquidating grocers had provided, on an average, 46 percent of their own initial capital, had borrowed from friends and relatives, 16.5 percent, from commercial banks, 14.3 percent, and had received assistance from wholesalers and jobbers to the extent of 10 percent. Fixtures acquired on time payments approximated 9.5 percent of the capital at organization.

[27] U. S. Department of Commerce, Domestic Commerce Series No. 54, "Causes of Business Failures and Bankruptcies of Individuals in New Jersey in 1929–30."

[28] Wm. O. Douglas, "Some Functional Aspects of Bankruptcy," Yale Law Journal, vol. XLI, No. 3, January 1932, pp. 329–364.

[29] U. S. Department of Commerce, Trade Information Bulletin No. 627, "Credit Extension and Business Failures" 1930.

Proprietors of failing drugstores in St. Louis [30] had borrowed, upon establishing business, more of the capital from friends and relatives than was provided from their own resources, 36 percent and 32 percent, respectively. From former owners, 13 percent had been obtained and from commercial banks, almost 7 percent. Other sources aggregated 12 percent. An astonishing fact disclosed is that one-third of the proprietors made no personal investment.

Since funds obtained from personal finance companies are based not alone upon the borrower's assets but, in addition, upon character, it is difficult to distinguish loans made for business purposes from those for household use.

From State banking reports on purposes of personal loans [31] the following tabulation, table 100, is made of the number of loans obtained for stated business needs:

The average proportion of loans made by the two largest American companies for business capital in 1936 was 5.3 percent of the total number. The National City Bank proportion was reported as 11 percent in 1935.

An occupational classification of borrowers from Wisconsin personal loan companies in 1936, records owner-managers with 12.29 percent of the number of loans and with 14.82 percent of the amount; the number represented exceeded 7,800 loans and the amount, 2¼ million dollars. A comparison of this occupational classification with the the 8.6 percent recorded above illustrates the difficulty of allocating purposes. A further illustration from the same source is represented in the following categories, table 101 adapted from a Pennsylvania report covering 1936:

TABLE 99.—*Sources of original capital, New Jersey and Boston bankrupts*

Source of capital	New Jersey percent of total capital	Boston percent of total capital
Owner, without borrowing	18.4	77.5
Friends and relatives	19.9	4.6
Life insurance	3.7	.4
Commercial banks	32.1	6.9
Finance companies	18.4	6.0
Wholesalers, jobbers, and manufacturers	5.5	.9
Fixtures, on installment	2.0	3.7
Total	100.0	100.0

TABLE 100.—*Proportion of personal loans for business purposes*

State	Percent of total number of personal loans
Iowa	6.9
Kentucky	5.7
Pennsylvania	5.7
Wisconsin	8.6

[30] U. S. Department of Commerce, Domestic Commerce Series No. 59, "Causes of Failure Among Drug Stores," 1932.
[31] M. R. Neifeld, Personal Finance Comes of Age, 1939

TABLE 101.—*Business borrowers from Pennsylvania personal finance companies*

Occupation	Number of loans	Percent of total number
Executives	14, 186	4. 56
Commission agents and salesmen	9, 645	3. 10
Retail merchants	18, 296	5. 89
Professional	6, 619	2. 13

Though obtaining loans upon personal credit, all of the above groups are in position to employ these funds for business purposes.

An index of financial solvency for industrial enterprises has been suggested by Fitzpatrick [32] as follows: When 70 percent of the capital funds have been provided by owners, "condition excellent"; when 65 percent is from owner source, "condition very good"; when 60 percent "good"; from that point, decreasing ownership—financing becomes fair and problematical. For retailers, it is suggested that not less than 50 percent of the capital employed in the business should be owner-contributed.

USE OF CAPITAL

It is apparent that the use of capital investment is a continuing process and closely related to costs and operation, debit position, and plant capacity. These related categories are treated later in analyses of business costs, assets and liabilities, and credit extension.

But at this stage there are certain illustrative uses of significance in studying the solvency of enterprises.

Among business practices controversial in nature, difficult of appraisal, and, in instances, subject to fraudulent misrepresentation, is the valuation of intangibles, such as goodwill, and of property rights in patents and copyrights.

The process of establishing goodwill assets and some misleading results are illustrated in the case of the Young, Smyth, Field Co. dissolved in 1923. Fitzpatrick [33] comments as follows:

> The ratio of "other" assets to total assets shows a decided growth from 2 percent in 1915 to 30.9 percent in 1916. This is on account of an issue of $1,000,000 in common stock and the setting up on the balance sheet of an offsetting item, goodwill, for the same amount. Consequently, the net worth item is affected favorably. This can be seen by the good showing of the two ratios in 1916; net worth to debt, and net worth to fixed assets.

The ratios to which he refers are 227 and 450, respectively.

An instance of questionable appraisal of worth is quoted from Douglas: [34]

> No. 186 was a "one man" corporation organized with a paid-in capital of $2,000 engaged in a retail radio business. The sole stockholder had gone through bankruptcy in 1911 while engaged in a similar retail business. At the end of teh first 6 months he issued a financial statement to R. G. Dun & Co. over his own signature, showing a net worth of $4,000; at the end of the year another showing a net worth of $5,000 and a few months before bankruptcy another giving assets as $16,000, liabilities as $4,500 and the net worth as $11,500. In a year and a half after beginning business a petition was filed. The assets then were $13,000 and the liabilities $19,000. No possible explanation appears for such radical change in

[32] Paul J. Fitzpatrick: The Problem of Business Failures, 1936.
[33] Paul J. Fitzpatrick: "Symptoms of Industrial Failures as Revealed by an Analysis of the Financial Statements of the Failed Companies, 1920-29"; Catholic University, Washington, D. C.
[34] William O. Douglas: Op. cit.

the last few months. It seems that the company was insolvent during the greater part of its existence.

Frequently, an act is designated as speculation only when it does not prove to be business sagacity. Had the estimated market for phonographs materialized as estimated, the $5,000,000 expansion program of the Columbia Gramophone Manufacturing Co., previously mentioned, would have been business foresight. At what point does the action of the Columbia Co. differ from the Chicago operator "of 62 years, who had lost $100,000 in real estate speculation," and who "is convinced that he will soon recoup his fortune by the same process"? [35]

The Chicago study attributes 7 percent of the bankruptcies to speculation with almost 5 times as many real estate as stock speculations. In addition, many individuals contracted interest and amortization obligation in the purchase of a residence far beyond the possibilities of current income, considering other, irreducible commitments, as well. Such action is based upon optimism with respect to future profits; profits failing to materialize, heavy withdrawals from business capital ensue.

In summary, the need for guiding principles for organizing and operating business units is obvious. In establishing a job-printing concern or a delicatessen, maximum results depend upon knowledge of many elements from location advantages to delivery facilities. What is the most efficient relationship of machines and fixtures to personnel? What is the minimum investment needed for a safe start? What amount should be available for current operations? What is the danger point of debt? Answers differ by kinds of business, types of operation, and many other factors. And the prospective proprietor is anxiously in need of enlightenment. At present he is using the trial and error process, and the odds are heavily against him.

[35] John H. Cover: "Business and Personal Failure and Readjustment in Chicago," University of Chicago, 1933.

CHAPTER IX

CONTROL OF ASSETS AND LIABILITIES

In the treatment of capital, two uses of assets and liabilities were employed in illustrating insolvency: the excess of assets over liabilities, or the net invested capital, and the margin of current assets over current liabilities, or the working capital. Invested capital is the fund provided by owners plus reinvested earnings; current and long-time liabilities are capital loaned by creditors.

The accountants use and recommend as helpful guideposts for managers and creditors a number of ratios indicating the relative position of asset and liability items.

As the result of a detailed analysis of Illinois [2] experience it is suggested that balance sheet ratios might provide significant evidence for predicting the probable future operation of old companies. Some analysts particularly favor such ratios as net worth to debt and net profits to net worth.

As an instance of their use, a comparison [3] of the ratios of solvent and failing companies manufacturing pianos is presented in table 102.

TABLE 102.—*Ratio comparisons of successful and failed concerns—piano manufacture*

Type of ratios	Failed concerns			Successful concerns		
	Dec. 31, 1926	Mar. 31, 1928 [1]	Mar. 31, 1929 [1]	Dec. 31, 1926	Dec. 31, 1927	Dec. 31, 1928
1. Current assets to current liabilities	306.0	203.0	277.0	887.0	793.0	1,039.0
2. Quick assets to current liabilities	148.0	91.0	125.0	614.0	544.0	725.0
3. Sales to fixed assets	301.0	290.0	243.0	842.0	76.1	696.0
4. Sales to inventories	238.0	287.0	321.0	385.0	326.0	311.0
5. Sales to receivables	309.0	483.0	521.0	174.0	153.0	140.0
6. Sales to net worth	82.0	103.0	88.0	140.0	123.0	108.0
7. Net worth to debt	458.0	296.0	525.0	288.0	282.0	326.0
8. Net worth to fixed assets	390.0	287.0	285.0	603.0	621.0	642.0
9. Inventories to receivables	130.0	168.0	162.0	45.0	46.0	45.0
10. Net profits to net worth	12.0	3.5	−1.7	8.0	5.1	3.6
11. Current assets to total assets	54.8	48.4	41.9	87.7	88.1	88.1
12. Fixed assets to total assets	21.1	26.0	29.4	12.3	11.8	11.9
13. Other assets to total assets	24.0	25.5	28.6	None	None	None

[1] No statement published Dec. 31, 1927 and 1928.

In the last year of the failed firm, the first ratio, which theoretically should be a minimum of 200, and the second, which should not fall below 125, are satisfactory. Fitzpatrick comments:

The declining tendency of the sales to fixed assets ratio and the ratio of net worth to fixed assets indicates overinvestment in fixed assets. The fixed assets to total assets ratio confirms this fact. The sales to fixed assets means that the failed company is only obtaining $2.43 of sales to each dollar invested in fixed

[1] For an illuminating study of the financial characteristics of large and small manufacturing corporations see T. N. E. C. Monograph No. 15 by Charles L. Merwin.

[2] University of Illinois, Bureau of Business Research, Bull. No. 40, "A Demonstration of Ratio Analysis," 1931.

[3] Paul J. Fitzpatrick: "A Comparison of the Ratios of Successful Industrial Enterprises With Those of Failed Companies," The Certified Public Accountant, October, November, and December, 1932.

assets, while the successful concern shows $6.96 of sales to each dollar invested in fixed assets.

The sales to receivables ratio is high and increasing for the failed concern. This condition is satisfactory if the company is not hypothecating its receivables or maintaining too strict a credit policy.

Furthermore, there is the important fact that sales have dropped from the high mark of $14,300,000 in 1924 to $11,400,000 for the year ending March 31, 1929, as the financial statements reveal.

The net worth to debt ratio is very good for both companies, although the failed concern's ratio is higher. Incidentally, this is one of the few unsuccessful companies, in this investigation, reporting a favorable position.

FIXED ASSETS

Investment in plant and equipment is made in anticipation of future use. The further the business process in time and space from the ultimate market, the greater the need of advance planning. In addition, fluctuations in business conditions require estimates as to the changing market. A boom or fortuitous event may easily be mistaken for the beginning of a long period of vigorous growth in demand, and an expansion of facilities be predicated upon this judgment. Investing capital in fixed assets necessarily withdraws it from use for operating purposes, and should the expected demand for goods not materialize, there is likely to be an excess of plant capacity accompanying a shortage of capital for meeting current obligations.

Expansion of plant of the American Chicle Co.[4] illustrates the unbalancing of financial structure. There was an increase of fixed assets of more than 100 percent between 1918 and 1920. This change was based upon war impetus to the demand for its product.

The American soldiers took abroad the chewing-gum habit and spread the idea among the soldiers of foreign armies. The company received large orders from the American and British Governments for the armies. Besides, the Red Cross, Knights of Columbus, Y. M. C. A., and other organizations placed orders. Shops in Paris began to sell chewing gum. Furthermore, the high price of candy increased the sale of gum. Prohibition was also a factor.

A comparison of assets scheduled by 570 bankrupts in Boston,[5] table 103, indicates accounts receivable as a large proportion of claimed assets, a high fixture investment for the service group, and a large miscellaneous item for manufacturers. Since these assets are posted by the bankrupts, the proportion that ultimately will be realized by liquidation may be small. From accounts receivable must be deducted bad debts.

TABLE 103.—*Scheduled assets of 570 bankrupt enterprises, excluding real estate*

Classification	Number reporting	Total assets	Percent of total assets			
			Accounts receivable	Stock in trade	Fixtures	Other assets
Manufacturers	54	$947,962	14.7	10.6	17.2	57.5
Wholesalers—total	52	177,227	48.6	30.4	3.4	17.6
Retailers—total (merchandise)	218	294,762	42.3	30.3	7.7	19.7
Retailers—total (service)	66	28,580	42.7	7.2	19.4	30.7
Real-estate agents, or dealers, builders, and contractors—total	180	311,659	62.2	1.4	4.1	32.3
Grand total	570	1,760,190	31.6	14.2	11.9	42.3

[4] Paul J. Fitzpatrick: "Symptoms of Industrial Failures as Revealed by an Analysis of the Financial Statements of the Failed Companies, 1920–29," Catholic University.
[5] U. S. Department of Commerce, Domestic Commerce Series No. 69.

When failure is inevitable, assets posted as security are claimed, fixtures and implements rented or sold on installment contracts are removed, and dissolution is rapid. All other creditors hold claims against the general assets, with certain types, such as taxes and wages, in preferred position.

The extent of business transacted on limited fixed assets is illustrated in the experience of restaurants and women's clothing concerns in Chicago. Both these trades normally require large amounts of fixed assets in their business. Only one-half of the restaurants and one-third of the clothing concerns had annual sales five times or more the investment in fixed assets.

RECEIVABLES

With excessive investment in receivables, a concern is impairing its own working capital by extending too much credit to customers. In the case of firms with inadequate capital, the credit extended to it is, in effect, being passed on to customers. With liquidation, the firm's creditors are faced with the problem of realizing upon this chain of financing.

Credit sales formed a small proportion of total business in most of the fields represented in the Chicago study. Receivables represented, on an average, 17 percent of credit sales of women's clothing; restaurants were next lowest with 25 percent, while men's clothing stood highest, at 76 percent.

In table 103 receivables are averaged for business groups as percentages of total assets. Among retailers, furniture dealers averaged 88 percent, and in the building group, electrical contractors listed receivables as 100 percent of assets.

CURRENT ASSETS

Excess of current liabilities over current assets means lack of working capital, since funds for operation should necessarily be free from obligation and therefore represent the difference between current assets and current liabilities.

When the term "lack of capital" is used in studies of failures, some times working capital is meant, other times both fixed and working capital. Certainly both are significant in gaging the efficiency of an enterprise, but the items should be separated for analysis, particularly since their significance varies with business fields.

Of the Chicago bankrupt firms, 11 percent had no assets. Current assets, including cash, receivables, and the average inventory for the year preceding failure, equaled or exceeded liabilities in 11 percent of the cases. But assets as scheduled by bankrupts are usually highly inflated values, as reference to realized assets will suggest. More than one-fourth of all cases had scheduled assets of less than 10 percent of their liabilities, and an additional fourth, from 10 to 29 percent.

A frequent occurrence in business, in an effort to expand facilities, is the shift of capital from current to fixed assets. In 1919 the Goodyear Tire & Rubber Co.[6] had 63.7 percent of total assets invested in current assets, and 30 percent in fixed assets. In 1920, only 35.2 percent of total assets were in current assets while 61.5 percent were in fixed assets.

[6] Paul J. Fitzpatrick; op. cit.

REALIZED ASSETS

One-half of the Chicago [7] failures either had no assets or such small amounts that none remained for distribution after liquidation for the benefit of secured creditors or the granting of exemptions. Except in the case of corporations, $400 exemption was granted for the head of a family, $100 for an unmarried person, or a person not the head of a family, and $1,000 if a home was owned. A period of 2 years within which to close bankruptcy cases is permitted by law; in Chicago 18 months was about the average time.

In addition to the no-asset cases, one-half of the remaining individual proprietors had realized assets of less than $1,000, and almost 55 percent of the corporation and partnership groups and 78 percent of the individual proprietors had less than $2,000.

Analyzing the proportions of realized assets (excluding secured assets and exemptions) which were expended in court administrative procedure, it was found that, for the sample available, 29 percent of the individual proprietor cases had required 100 percent of the realized assets in expenses of administration. In many cases the bankrupt is permitted to retain clothing and personal household effects. If liquidable assets, not held as specific security against indebtedness, remain, the receivers', trustees', attorneys' fees and referees' expenses are next deducted. Wages and taxes are preferred claims. General creditor claims share the residue. All realized assets were spent for administrative purposes in 5 percent of the corporation and partnership cases. Accounting for much of this apparently excessive cost of administration is the fact that low-asset cases are disposed of more easily and, therefore, earlier on the calendar.

There is direct relationship between the percentage of realized assets spent for administrative purposes and the total amount of realized assets, the expenditure percentage decreasing as the amount increases. This is natural, since there are basic fixed charges for even no-asset dissolutions. Forced sales of assets bring small returns.

To discover the extent to which creditor claims are realized, dividends were expressed as percentages of filed claims. In the case of one proprietor and of one corporation, dividends aggregated 40 percent of the claims filed; the corporations and partnerships record a higher percentage of realized claims than do individual proprietors. This fact is due to the far more complete records of corporations and partnerships, permitting a check upon the liquidity of the concerns by creditors prior to credit extensions, and to the nature of the assets of corporations and partnerships, frequently assuring them of greater market value.

In only one case did the amount of assets realized at forced sale equal the amount of assets scheduled by the debtor. Realization through sale in the case of individual proprietors is less than 15 percent of estimated values for almost 47 percent of the bankruptcies, and for 34 percent of corporations and partnerships.

These deflations of value are due largely to the optimism of the debtor in evaluating his assets, in instances apparently a studied policy to present a favorable case, and to the degree of sacrifice represented in forced sales.

In estimating losses to general creditors, creditors' claims or scheduled liabilities—whichever was the larger item—and claims paid

[7] John H. Cover, op. cit.

were used. In 8 percent of the corporation and partnership cases no claims were paid; this percentage mounted to 29 in individual proprietorships. Only one case, a corporation, paid claims approximating as high as 30 cents on the dollar.

No correlation is apparent between the percentage of losses of liabilities or claims, on the one hand, and the amount of claim or liability, on the other.

Since business concerns with no assets or with very limited assets can be liquidated easily if no other complications are involved, it is probable that the cases that have been closed do not fully represent the total picture. The extent of bias of this sample is difficult to determine, but in consideration of realized assets and losses the sample is probably more representative of economic waste than one should like to admit.

In more than 70 percent of the individual proprietor cases and 50 percent of the combined corporations and partnerships, the assets of the concern as estimated by the debtor were less than $7,500.

Table 104 details the disposition of realized assets, and the relation of realized to scheduled assets in 11 cases of drug-store failure in St. Louis.[8] The average proportion of scheduled assets which were realized was 39 percent. The percentage of realized assets paid to unsecured creditors, last column, is unusually large, and should not be confused with the percentage of unsecured claims that were paid.

TABLE 104.—*Scheduled assets of 11 failed*[1] *drug stores compared to realized assets and disposition of realized assets, St. Louis, 1925–31*

Store No.	Assets			Unsecured claims			Cost of administration		Miscellaneous payments		Percent of realized assets paid unsecured creditors
	Scheduled	Realized	Percent realized	Amount	Amount paid	Percent realized	Amount	Percent of realized assets	Amount	Percent realized	
7	$860	$706	82.1	$3,380	$455	13.5	$122	17.3	$129	18.3	64.4
9	1,880	573	30.5	1,379	370	26.8	203	35.4			64.6
10	1,267	1,218	96.1	4,623	134	2.9	853	70.0	231	19.0	11.0
15	720	720	100.0	1,737	400	23.0	320	44.4			55.6
16	2,118	514	24.3	2,637	131	5.0	82	16.0	301	58.5	25.5
17	27,940	9,820	35.1	47,144	8,486	18.0	1,334	13.6			86.4
20	4,214	1,517	36.0	5,649	328	5.8	488	32.2	701	46.2	21.6
21	11,693	3,402	29.1	13,100	2,182	16.7	1,220	35.9			64.1
23	489	240	49.1	2,539	51	2.0	105	43.8	84	34.9	21.3
26	3,696	1,824	49.4	11,992	809	6.7	1,015	55.6			44.4
27	15,739	7,018	44.6	15,871	4,455	28.1	2,171	30.9	392	5.6	63.5
Total	70,616	27,552	39.0	110,051	17,801	16.2	7,913	28.7	1,838	6.7	64.6

[1] 7 of these failures were bankruptcies and 4 assignments.

An analysis of the distribution of assets in 10 grocery proprietor cases in Philadelphia,[9] disclosed that creditors with secured loans obtained 2.3 percent of the assets, and general creditors 14.3 percent. The bankrupts' exemptions consumed almost 17 percent and costs of administration in excess of 66 percent. Attorneys' fees constituted almost 44 percent of the administrative expenditures.

Business liabilities were used to disclose information regarding sources of initial business capital, and will be serviceable again in the

[8] U. S. Department of Commerce, Domestic Commerce Series No. 59, 1932.
[9] U. S. Department of Commerce, Trade Information Bulletin No. 700.

consideration of business costs. Just as there is a difference between the value of scheduled, or claimed, assets, and the market realization upon those assets, so, also, there is frequently a variation between liabilities claimed by creditors and admitted by debtors. Entering into this problem are the debts claimed by insolvents as due relatives or friends and challenged by other creditors as evasions.

The average of assets, excluding real estate, scheduled by 602 bankrupts in New Jersey [10] was $5,476, and of liabilities scheduled, $29,202. In 33 real-estate cases, liabilities exceeded assets by more than $4,000,000.

In the period 1920–31, the percent of bankruptcy liabilities in the United States as a whole that was paid ranged from 13.14 percent in 1921 to 6.70 percent in 1931, an average of 8.43 for the 12 years.[11] From the same source is summarized in table 105, the proportions of liabilities owed various sources by Boston bankrupts.

TABLE 105.—*Scheduled liabilities of 570 bankrupt Boston enterprises, excluding collateral and real-estate mortgages*

Classification	Percent of total liabilities to—									
	Wholesalers	Finance companies	Morris Plan banks	Other banks	Goods on installment	Judgments	Retailers	Professional services	Personal services	All others
Manufacturers	34.4	0.4	4.0	9.0	0.1	0.1	0.2	0.5	12.8	38.5
Wholesalers	47.7	.3	1.1	8.9	.3	2.4	.5	.6	32.8	5.4
Retailers (merchandise)	54.1	1.1	.2	10.6	.5	.4	1.2	.9	15.6	15.4
Retailers (service)	9.0	.5	.1	7.5	1.5	22.0	7.3	1.3	19.6	31.2
Real-estate agents or dealers, builders, and contractors	35.4	.7	2.0	8.4	.1	.6	.5	.8	35.0	16.5
Grand total	38.5	.6	1.7	8.9	.2	2.5	1.2	.7	25.7	20.0

Bankrupt New Jersey [12] manufacturers owed almost 50 percent of their indebtedness to wholesalers, jobbers, and other manufacturers, 19 percent to commercial banks, and almost 17 percent to individuals. Wholesalers were indebted for 71 percent of their obligations to the wholesaler-manufacturer-jobber group, and retailers, on an average, 46 percent to the same group. Wholesalers owed almost 8 percent to commercial banks and 14 percent to individuals. The other principal liabilities of retailers were 10 percent to commercial banks, 19 percent to individuals, and 18 percent to miscellaneous creditors. Preferred claims, including taxes and rent, averaged 6.6 percent, while equipment dealers were due, on an average, only one-tenth of 1 percent.

SECURED LIABILITIES

Collateral security safeguarded some portion of the indebtedness of only one-half of the Chicago [13] proprietors. Of the proprietors with some security, more than 18 percent had less than 5 percent of total liabilities protected, and 44 percent of the proprietors had collateral covering less than 15 percent of their indebtedness.

[10] U. S. Department of Commerce, Domestic Commerce Series No. 54.
[11] U. S. Department of Commerce, Domestic Commerce Series No. 69.
[12] U. S. Department of Commerce, Domestic Commerce Series No. 54.
[13] John H. Cover: Business and Personal Failure and Readjustment in Chicago: University of Chicago, August 1933.

INSTALLMENT DEBTS

The small proportion of liabilities due installment creditors in Boston, as indicated in table 105, is duplicated in the Chicago experience, where only 13 proprietors had installment goods debts outstanding. In part, this is due to a stringent credit control, and, in part, it represents merely residue of accounts, most creditors reclaiming the chattels upon failure of a debtor to meet installments.

FINANCE COMPANY OBLIGATIONS

Obligations to loan and finance companies at the time of liquidation appear to be negligible in most categories of business. In 1929 and 1930, however, failing New Jersey [14] retail automobile dealers were indebted to finance companies for almost 29 percent of their liabilities, and the miscellaneous group of contractors owed almost 8 percent of total debts to this source. Boston [15] hucksters and peddlers and radio and musical instrument dealers were obligated in excess of 6 percent of total debts. Approximately 14 percent of Chicago failing proprietors had obligations in this category. However, in 87 percent of the cases, this source represented less than 15 percent of liabilities, and in 39 percent of the concerns, less than 5 percent.

OBLIGATIONS TO WHOLESALERS

Heavy obligations to wholesalers of Boston bankrupts is illustrated in table 105. Jewelry retailers owed in excess of 96 percent of scheduled indebtedness to wholesalers, while dealers in boots and shoes and furniture, and hucksters and peddlers were obligated to wholesalers for more than 73 percent of total liabilities. In Chicago, 13 percent of retail clothiers were exclusively indebted to wholesalers and 18 percent of the food dealers owed 90 percent or more of their liabilities to wholesalers.

INDEBTEDNESS FOR RENT

There appeared, in the Chicago study,[16] to be some relationship between the total amount of liabilities and the percentage of such indebtedness owed to landlords. The ratio of rental obligations tending to be larger with larger liabilities up to $40,000 of total liabilities. The extent to which this relationship applies, would offer a basis for credit control; however, 52 percent of the individual proprietors owed no rent.

In tables 106 and 107 are summarized the Chicago experience by percentages of proprietors and amounts of liability, respectively. Additional sources of debt obligations are represented also.

Analysis of records of failed concerns and comparison with solvent establishments clearly discloses the problems unsurmounted in one case and solved in another. While no set of standards will automatically assure successful control of an enterprise, the value of various comparisons as indexes of welfare is apparent. In most failures, the checks were not applied in time, or their availability as storm signals not realized.

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[14] U. S. Department of Commerce, Domestic Commerce Series No. 54.
[15] U. S. Department of Commerce, Domestic Commerce Series No. 69.
[16] John H. Cover: Op. cit.

TABLE 106.—*Percentage of all proprietors with particular types of indebtedness*

Business	Total number of firms	Percentage of firms with respective debt types								
		Secured by collateral	Loan and finance companies	Banks	Installment goods	Retailers	Professional services	Individual persons	Rent	Wholesalers
Groceries	42	66.67	23.81	11.90	--------	2.38	21.43	38.10	52.38	95.24
Total, food	91	60.44	14.28	14.28	--------	5.49	21.98	34.06	50.55	93.41
Restaurants	32	53.12	6.25	15.62	6.25	12.50	18.75	50.00	62.50	90.62
Drugs	28	57.14	14.28	28.57	7.14	10.71	14.28	39.29	64.28	89.28
Total, men's clothing	35	45.71	14.28	17.14	--------	8.57	22.86	20.00	54.28	97.14
Total, women's clothing	72	41.67	6.94	15.28	--------	4.17	15.28	25.00	38.89	97.22
Total, clothing	134	41.79	9.70	14.18	--------	5.97	17.91	28.36	41.04	97.76
Total, retail	498	49.00	13.25	17.27	1.40	7.03	18.88	37.95	48.19	93.57
Total, wholesale	22	50.00	13.64	45.45	--------	--------	9.09	27.27	31.82	95.45
Total, manufacturing	46	45.65	17.39	19.56	--------	13.04	15.22	26.09	58.70	95.65
Agriculture	4	75.00	50.00	50.00	25.00	50.00	50.00	75.00	--------	75.00
Miscellaneous trade and service	53	47.17	18.87	24.53	9.43	18.87	33.96	50.94	52.83	69.81
Real estate	38	65.79	21.05	34.21	2.63	13.16	36.84	44.74	31.58	78.95
Total	661	49.77	14.67	20.12	2.12	8.77	20.73	38.43	47.50	90.92

TABLE 107.—*Percentage of amounts of total liabilities in particular debt categories—individual proprietors*

Business groups	Total liabilities in dollars	Percentage of total amounts in respective sources								
		Secured by collateral	Loan and finance companies	Banks	Installment goods	Retailers	Professional services	Individual persons	Rent	Wholesalers
Groceries	558,489	46.00	1.77	1.53	-------	0.01	0.44	3.16	9.53	26.49
Total food	883,180	38.40	1.36	1.89	-------	.22	.62	5.21	10.53	30.39
Restaurants	495,493	21.72	.08	.86	0.06	.51	.54	7.14	29.23	32.66
Drugs	439,527	13.45	.25	1.31	1.02	.07	.15	4.92	31.01	34.66
Total, men's clothing	272,102	14.85	1.03	6.95	-------	.12	.76	5.62	9.88	50.84
Total, women's clothing	753,253	13.42	.32	1.68	-------	.07	.17	6.32	3.37	60.38
Total, clothing	1,362,814	20.28	.49	2.56	-------	.08	.29	6.41	4.21	55.16
Total, retail	5,749,919	25.12	.94	2.46	.11	.40	.40	7.71	11.21	41.53
Total, wholesale	378,911	30.41	.35	7.62	-------	-------	.43	6.69	1.58	51.36
Total, manufacturing	1,920,073	63.76	.82	.65	-------	.31	.23	2.71	2.06	22.23
Agriculture	21,540	28.73	3.97	8.96	1.09	8.44	.52	2.90	-------	23.14
Miscellaneous trades and services	1,055,821	40.48	1.16	2.08	.36	1.44	.77	9.02	17.60	12.10
Real estate	8,440,240	76.73	1.03	3.25	.003	.22	.28	4.13	.31	7.22
Total	17,566,504	55.18	.97	2.74	.06	.37	.35	5.49	5.13	21.36

It is apparent from observation of the activities of proprietors upon discovery of the insolvency of their concerns, that emphasis is placed upon obtaining more credit rather than upon curtailment of operations. This is a logical move since returns on the investment already made appear just around the corner, and since, as the experience with costs to be discussed next, have shown, outstanding and contractual obligations are difficult to adjust.

While bankruptcy liquidations are not necessarily representative of other liquidation procedures, they are accomplished under Federal court jurisdictions and the records are relatively more complete than in more casual devices.

CHAPTER X

CONTROL OF COSTS OF OPERATION

With sharp fluctuations in business conditions, expenses of smaller firms appear less elastic, and therefore more difficult of adjustment, than larger; and expenses in the field of distribution apparently are more rigid than in manufacturing, extractive industry, or transportation.

McNair [1] is of the opinion that the costs of marketing have become slightly greater than the costs of manufacture for manufacturing firms as a group, but that part of the difference is due to a shifting of costs from manufacturing operations to marketing. In absolute terms, Willis [2] reports that distribution costs in groceries have decreased at least 15 percent in the last 15 years. A general statement of the problem has recently been published by the Twentieth Century Fund.[3]

OVERHEAD COSTS

The largest item of mismanagement apparent in the review of Chicago [3] bankrupt enterprises was found to be the failure to control overhead expenses; this accounted for the insolvency of 12 percent of the dissolved concerns.

OVERHEAD AND SALES

The ratio of total overhead to net sales is a good measure of control. The Cinchona Club of St. Louis studied this relationship for 40 solvent retail drug stores, and the results have become useful as a standard in analyzing insolvent enterprises. The average ratio was 29 percent as compared with 38 percent for 29 failed drug stores.[4] The highest ratio for going concerns was 41 percent, appearing in 2 cases; the highest for failed concerns was 98 percent, with 14 of the 29 exceeding the maximum ratio of the active group.

In table 108 are listed the average ratios for bankrupt business firms in Chicago.

TABLE 108.—*Percentage total overhead of total net sales*

Type of business	Number of firms	Median percent	Mean percent
Drugs	35	47.0	79.5
Restaurants	34	48.5	65.6
Men's clothing	38	60.0	70.5
Women's clothing	63	48.5	62.4
Total, clothing	130	53.7	68.6
Food	90	40.0	57.2
Hardware	17	59.0	77.2
Furniture	21	61.2	87.0
Total retail	524	53.5	73.5
Manufacturing	126	59.2	92.0
Wholesaling	34	47.5	56.4
Miscellaneous services [1]	89	97.3	117.2
Total bankrupts	773	56.3	81.0

[1] Professional, miscellaneous proprietor, contractor, and realtor.

[1] M. P. McNair: Marketing and Our Economic Future. Address before special session for business executives, Department of Economics and Business Administration, Westminster College, 1938.
[2] Louis Boder: Recent Price Legislation and Economic Theory, Journal of Marketing, volume III, No. 2, October 1938.
[3] Twentieth Century Fund: Does Distribution Cost Too Much?, 1939.
[4] See Domestic Commerce Series No. 59.

For comparison, the following averages (means) of overhead-to-sales ratios are given for groups of Chicago "going concerns":

	Percent		Percent
Drug stores	29	Grocery stores	20
Men's clothing stores	27	Hardware	35
Women's clothing stores	30	Furniture	32

From an analysis of expenses of retail meat stores in Chicago, Cleveland, and New York,[5] it was found that the average ratio of overhead to sales was 19.5 percent with the most frequent range from 17.5 to 23.5 percent. The variation by size of store is given as follows:

	Averages (percent)	Common amounts (percent)
The total expense for—		
1-man stores	25.0	21.5–29.0
2-man stores	20.0	17.5–22.5
3-man stores	18.5	16.5–20.0
4-man or larger stores	16.5	15.4–18.5

RENT

In attempting to segregate expenditure items for study, it is frequently found that proprietors fail to allocate expenses for services not requiring a cash outlay. For instance, an enterpriser who owns the building in which his store is located may not charge off as rental an amount approximating the income he would receive from a lease to a similar business, or the interest on the value of the property plus repairs and taxes.

Women's clothing stores in Chicago[6] paid the highest median rental, $3,000, even exceeding the median of the manufacturing concerns, $2,470. This is explained by the need of central locations by clothiers, where high rentals are charged for small space. Median rentals of other groups were as follows: Men's clothing, $2,170; food stores, $1,280; drug stores, $2,300; restaurants, $1,960; wholesalers, $1,700.

RENT AND SALES

Ratios of rentals to sales for Chicago[7] bankrupts are given in table 109. The following range of rentals of solvent concerns, operating in various Chicago neighborhoods in which bankruptcies occurred, are offered for comparison:

Rent as percentage of sales

Kind of business:	Low and high
Drug	4.7– 8.8
Grocery	6.0–10.0
Men's clothing	9.0–14.0
Haberdasheries	10.0–14.0
Women's clothing	6.0–10.0
Women's specialty	10.0–15.0
Hardware	10.0–12.0
Confectionery	10.0–26.0
Shoes	4.0–12.0
Books	8.0–12.0

[5] Horace Secrist, "Expenses, Profits and Losses in Retail Meat Stores," Northwestern Bureau of Business Research, Series III, No. 9, 1924.
[6] John H. Cover: Op. cit.
[7] John H. Cover: Op. cit.

TABLE 109.—*Percentage business rent of total net sales*

Types of business	All known cases—			Excluding "no rent" cases—		
	Number of firms	Median percent	Mean percent	Number of firms	Median percent	Mean percent
Drugs	35	16.5	25.0	35	16.5	25.0
Restaurants	33	13.8	16.0	33	13.8	16.0
Men's clothing	38	19.4	25.5	36	20.0	27.0
Women's clothing	68	13.5	19.4	68	13.5	19.4
Total clothing	135	15.3	21.8	133	15.6	22.1
Food	99	9.5	13.0	99	9.5	13.0
Hardware	18	15.0	22.5	18	15.0	22.5
Furniture	22	19.0	26.7	22	19.0	26.7
Total retail	542	14.3	22.6	532	14.6	23.0
Manufacturing	137	5.8	9.5	136	5.9	9.6
Wholesaling	35	4.1	6.5	31	4.7	7.3
Miscellaneous services [1]	109	10.0	23.3	89	15.5	28.7
All bankrupts	823	11.9	19.3	788	12.6	20.0

[1] Professional, miscellaneous proprietor, contractor, and realtor.

Rentals of solvent retail drug firms in St. Louis [8] ranged from $540 to $3,775 annually, while failed outlets ranged from $600 to $6,800. The average for successful concerns was $1,629, and for liquidating stores, $1,939.

For going concerns, the average ratios of rentals to net sales was 4.7 percent, and for failing enterprises, 10.6 percent. The range of the former was from 2.2 to 9.8 percent, and the spread of the latter, from 5.1 to 36.4 percent.

Experiences of retail meat stores in Chicago, Cleveland, and New York [9] are summarized as follows:

	Percentage of net sales—	
	Average	Common amounts
Rent for—		
1-man stores	3.5	2.6–4.0
2-man stores	2.6	1.6–3.3
3-man stores	1.4	.9–1.7
4-man or larger stores	1.7	1.2–2.2

The percentage ranges for the middle 50 percent, by cities, are—

Chicago	1.47–3.18
Cleveland	1.89–3.45
New York	1.67–3.68

PAY ROLL

Modal, or most frequent, pay rolls of Chicago bankrupts ranged from $1,000 for druggists to $3,750 for restaurants, and $7,450 for manufacturers. The medians of the salary-wage item were low for retail men's clothing stores, at $2,350 and high for manufacturers, at $16,780. Unfortunately, when members of families were employed part time, salary entries were frequently not made; in these instances payment in kind, as subsistence, was habitual.

Approximately two-thirds of total expense of retail meat dealers [10] is attributable to the wage bill.

[8] U. S. Department of Commerce, Domestic Commerce Series, No. 59.
[9] Horace Secrist: Op. cit.

PAY ROLL AND SALES

In the study of retail meat store [10] expenses, the wages of the proprietors were included. Since in the Chicago bankruptcy [11] study, proprietor withdrawals were treated separately as a combination of salary and profit, some differences are to be expected.

The following is given as the experience of meat retailers in the three cities:

	Percentage of net sales—	
	Average	Common amounts
Wages for—		
1-man stores	16.0	13.0–19.0
2-man stores	13.0	11.0–15.0
3-man stores	12.0	11.0–14.0
4-man or larger stores	10.5	9.0–12.0

It was found that stores making a profit showed an average ratio of 12.22 percent, and those experiencing a loss recorded 13.96 percent.

The Chicago pay-roll ratios are presented in table 110.

TABLE 110.—*Percentage pay roll of total net sales*

Type of business	All known cases			Excluding "no pay roll" cases		
	Number of	Median	Mean	Number of	Median	Mean
Drugs	35	14.0	29.1	31	16.0	32.9
Restaurants	29	32.0	36.7	29	32.0	36.7
Men's clothing	32	9.0	10.8	22	14.0	15.7
Women's clothing	63	17.2	21.7	61	17.8	22.4
Total clothing	123	12.2	16.4	100	15.8	20.2
Food	94	7.0	16.8	62	14.0	25.4
Hardware	17	0	9.0	7	16.2	21.8
Furnitue	19	22.5	20.4	14	30.0	28.0
Total retail	492	11.6	19.4	370	17.2	25.8
Manufacturing	125	31.8	54.0	120	32.5	56.1
Wholesaling	33	13.3	20.6	27	17.5	25.4
Miscellaneous services [1]	99	15.0	39.8	63	33.5	61.8
Total bankrupts	749	15.2	27.3	580	20.9	35.3

[1] Professional, miscellaneous proprietor, contractor, and realtor.

Solvent St. Louis druggists [12] had salary expenditures averaging 18.5 percent of sales, while liquidating concerns averaged 21.4 percent. The respective ranges were from 12.9 to 27.8 percent, and from 8.8 to 53.8 percent.

PROPRIETOR WITHDRAWALS AND SALES

Analysis of failing individual proprietors in Chicago indicated that management had some regard for the ability of their enterprises to support them. Modal, or most frequent, withdrawals ranged from $1,210 annually for restaurants to $2,500 for women's clothing establishments; medians extended from $1,690 for food stores to $5,020 for manufacturing concerns.

[10] Horace Secrist: Op. cit.
[11] John H. Cover: Op. cit.
[12] U. S. Department of Commerce, Domestic Commerce Series, No. 59, 1932.

That the concerns were, indeed, in trouble is indicated by the relation of withdrawals to sales in table 111. Normally, with a successful enterprise, some portion of proprietor withdrawals should be charged against salaries, the remainder declared as dividends from profits. In may instances, the proprietor was a parasite living upon a parasitic enterprise.

TABLE 111.—*Percentage withdrawals of total net sales—individual proprietors*

Type of business	All known cases			Excluding "no withdrawals" cases		
	Number of firms	Median	Mean	Number of firms	Median	Mean
Drugs	33	12.9	23.7	31	14.2	25.1
Restaurants	33	12.1	16.9	32	12.5	16.4
Men's clothing	37	27.0	33.7	37	27.0	33.7
Women's clothing	64	14.5	21.3	63	14.7	21.6
Total clothing	129	21.2	29.8	128	21.5	30.0
Food	96	13.7	19.8	95	13.9	20.0
Hardware	17	34.0	42.0	17	34.0	42.0
Furniture	21	26.0	32.0	19	27.0	34.0
Total retail	522	19.7	28.9	512	20.2	29.5
Manufacturing	128	11.9	23.7	125	12.2	24.2
Wholesaling	35	10.0	17.1	33	12.5	18.1
Miscellaneous services [1]	101	22.0	43.8	88	29.0	50.4
Total bankrupts	786	17.6	29.4	758	18.8	30.5

[1] Professional, miscellaneous proprietor, contractor, and realtor.

COSTS AND PRICES—MARGINS

While price fluctuations are of basic importance to all phases of business, here our interest is primarily the relationship of two sets of prices—buying price, or cost, and selling price.

Inferences drawn from the Chicago [13] failure study are in point:

It is general practice in this group to charge goods at original cost. This is natural, since retail price is regarded as a mark-up, establishing a margin for overhead and profit, and a decline in market price is the basis for calculating loss. However, this practice affects subsequent policy. If stock moves slowly, the emphasis is placed, not upon clearing this merchandise, but upon purchasing small lots of additional goods—necessarily at relatively greater per unit outlay. Moreover, since a stock of merchandise is seldom regarded as capital against which interest should be charged, the principal incentive for pushing sales is the need of cash.

This situation leads to the holding over of goods for the next corresponding season at a time when manufacturers, wholesalers, and jobbers are introducing new styles and new products as devices to increase business. The results include both further depreciation of old stock and a certain friction between sellers and buyers, the former already creditors for the depreciated stock. When a crisis is imminent, special effort is employed to dispose of the stock, but by this time only "price" sales are effective, and since other merchants are under economic pressure, cutthroat competition frequently occurs. In several instances a direct relation can be traced between sacrifice sales of an insolvent dealer under the necessity of obtaining cash and the subsequent insolvency of competitors whose customary sales have been depleted by the emergency liquidation.

As the process indicated above suggests, there are few instances in which a price policy exists or receives consideration as an important merchandising element. Although, as mentioned, a general idea of mark-up obtains, this idea does not include the concept of the retail price as the base upon which to establish costs, earnings, and profits. Nor is the mark-up even conceived of as a percentage of the cost of the commodity. It is an absolute amount added to the approxi-

[13] John H. Cover: Op. cit.

mate per-unit cost of merchandise to establish a price which the market should conceivably bear; the check of the estimate is the prevailing price in the neighborhood.

Consequently, though in some neighborhoods bargaining persists as a national habit, a "customary" price tends to become established. This lethargy does not yield to the elements commonly conceived to be present in competitive demand and supply except in the "bargaining neighborhoods" where the price established by mark-up tends to become a maximum rather than a "normal."

The established price, then, becomes a stabilizing factor; it yields most readily in an advancing market but resists declining tendencies. Without the concept of differential cost it is difficult to realize the significance of the new supplies, small in quantity, to the problems of profit and minimum price; and with an original cost base resisting price changes there is little warning of impending danger. Therefore, prices yield not gradually but suddenly when a substitute commodity (including style change), a new competitive device, creditor pressure, or a buying slump, develops.

A chain store with a different merchandising set-up, including slight price undercutting, is a new competitive device. Resentment against the chain is not merely the defensive reaction to a powerful competitor with advantages in purchasing, capital, and management mechanism; it includes, as well, indignation over the "unethical" practice of disregarding the established price.

With limited experience in estimating dispersion of sizes, qualities, and "lines" demanded purchasing and cost problems are further involved, making more complicated the determination of profitable and unprofitable goods. This dilemma adds to the difficulty of deciding upon products to be pushed.

Modifying the report that inventory is not taken, or is taken only at long intervals, is the fact that the proprietor's attention is concentrated upon depleted stocks. This is an informal and partial inventory device that may prove moderately adequate in a stable business period, but is likely in an unstable market to result in mere duplication of order and the stocking of out-of-date commodities.

In the absence of knowledge of inventory value and of relative costs of different policies, proprietor withdrawals of funds from business income for personal use may easily result in an impairment of capital. If, when he calculates at all, he thinks of the original cost rather than of the prospective market value of his inventory and of the established price rather than of potential price, the anticipated income automatically appears to cover his withdrawals. Though at least a portion should be regarded as profit and fluctuate with business success, the entire withdrawal is considered a fixed item and as rigidly determined by desire for a certain standard of living as is rent by a formal contract.

Analysis of retail meat store operations in Chicago, Cleveland, and New York[14] indicates a range of from 73 to 78 percent as the most typical ratios of the cost of merchandise sold to the sales value. This ratio is greater, on an average, for large volume than for small, and is smaller for stores making profits than for those incurring losses.

The most typical gross margins ranged from 23 to 27 percent of sales, the spread of the middle 50 percent of margins was from 19.5 to 28.5 percent of sales. The gross margin tended to decrease with increase of sales volume. Variations by size of staff are given as follows:

	Percent of sales	
	Average	Common amounts
Margins for—		
1-man stores	24.5	19.5–30.0
2-man stores	23.0	20.0–28.5
3-man stores	22.5	17.0–26.0
4-man or larger stores	21.0	18.5–23.5

The average rate for profit stores was 23.85 percent of sales and for stores with losses, 18.89 percent.

[14] Horace Secrist: Op. cit.

The average rate of profit for the stores making a profit was 5 percent of sales, and of loss for those incurring a loss, 3.56 percent of sales.

The following summaries offer comparisons of profit and loss stores:

Size of stores:	*Net trading profit (percent of sales)*
1-man stores	0.1
2-man stores	2.8
3-man stores	4.0
4-man or larger stores	5.0

The average result of operation of stores with varying gross margins is as follows:

Gross margin (percent of sales):	*Net trading profit (percent of sales)*
Below 16	[1] 5–8
16 to 20	[1] 1–2
20 to 24	1–2
24 to 28	3–5
28 to 32	8–9
32 and over	10–11

[1] Loss.

The average result of operation for stores of different size is a net trading loss when margins are as follows:

Size of stores:	*Margins (percent of sales)*
1-man stores, below	24
2-man stores, below	20
3-man stores, below	20
4-man or larger stores, below	16

The average result of operation of stores with varying total expenses is as follows:

Total expense (percent of sales):	*Net trading profit (percent of sales)*
Below 16	5.0–7.0
16 to 20	5.0–6.0
20 to 24	2.5–3.5
24 to 28	0.0–1.0
28 to 32	[1] 5.0–6.0
32 and over	[1] 9.0–11.0

[1] Loss.

The margins and expenses as percents of sales most conducive to earning a net trading profit are as follows:

For one-man stores: Margins, 26 to 36; expenses, 20 to 26.

For two-man stores: Margins 22 to 30; expenses, 16 to 22.

For three-man stores: Margins 20 to 28; expenses, 14 to 20.

For four-man or larger stores: Margins, 18 to 24; expenses, 12 to 18.

The margins and expenses as percents of sales most likely to produce a net trading loss are as follows:

For one-man stores: Margins, 18 to 26: expenses, 26 to 32.

For two-man stores: Margins, 16 to 22: expenses, 22 to 28.

The following are important conclusions from this study [16] of meat store operations: For three-man or larger stores, losses are rarely incurred. Losses are more common in small than in large stores.

[16] Horace Secrist: Op. cit.

Inadequate margins seem to be more responsible for losses than high operating expenses. Profits are most likely to be made when both margins and expenses are moderate in amount. The single most important explanation of the failure of merchants to make a reasonable profit was found to be cutthroat competition, resulting from poor location, price cutting, lack of records showing true costs, and easy entrance into the trade.

For limited-price variety chains, the net cost of merchandise sold in 1938 was, in the aggregate, 65.44 percent of sales, and the gross margin, 34.56 percent. The net profit was 2.38 percent, and the average sales volume per store, $182,000. The net profit rate in 1937 was 4.11 percent of sales, and in 1936, 5.05 percent. The 1938 decrease is attributed to a contraction of the gross margin rate and and increase in the expense rate.

Some observations of margins and profits in the Pittsburgh [16] meat market are indicative of the management problem merchants face:

Analyzing gross margins—the difference between retail and wholesale prices expressed as a percentage of the former—it was found that the highest priced cuts consistently showed the greatest margins, although the range of margins for lower-priced cuts was larger. The widest fluctuations occurred in beef and lamb prices, due in part to kosher influence, and, in addition, to the preference for pork and veal in the lower-income neighborhoods.

To the degree that margins indicate demand, that is, the wider the margin between retail and wholesale prices, the greater the consumption, the higher priced cuts were less expensive in the smaller-income areas than in the larger.

Almost one-half of the retailers had gross profits ranging between 20 and 29 percent of the sales price. A large proportion of independent meat markets was in the upper fringe of this range, while chain outlets were in the lower fringe.

Use of average and marginal cost technique, of practical consideration in large-unit enterprise, is a rapidly developing field.[17] The former is principally of value in the determination of flexible standards for cost control, the latter in arriving at the most profitable price and output policies.

Net profits as percentages of net sales for 35 manufacturing lines [18] show a range from a loss of 0.23 for the leather garments field to a profit of 6.15 for industrial machinery. None of the wholesaler groups reached 2 percent; the range was from a loss of 0.58 to a profit of 1.94 percent. The largest profit ratio for retailers was for the installment furniture dealers, 4.52 percent of net sales. The smallest was 1.21 percent for shoe retailers. No retail groups suffered a loss as a whole.

INVENTORY

The problem of the stock of goods on hand is fundamental to all commodity producing and distributing agencies. It is a management concern related to the use of capital, the market price structure, the solvency of an enterprise.

[16] John H. Cover: "Neighborhood Distribution and Consumption of Meat in Pittsburgh," University of Chicago Press, 1932.

[17] Joel Dean: "Statistical Determination of Costs, with Special Reference to Marginal Costs," University of Chicago Journal of Business, vol. IX, No. 4, pt. 2, October 1936.

[18] Roy A. Foulke: "Financial Ratios as Guides to Operating Policies", Dun's Review, December 1938.

Overhead expenses are increased by the carrying costs of inventory. Capital is tied up in the investment and is therefore not available for operating purposes. Frequently, credit facilities are used involving interest and the instability of the financial structure. Surplus of stock is a particularly difficult problem with a decline of selling prices, a change of style, or with a new invention.

The rate of stock turn for 15 identical variety chains [19] ranged from 5.24 in 1929 to 4.86 in 1933; the 1938 ratio was 4.90.

Rising sales normally are accompanied by declining stock-sales ratios. The ratios of inventory to sales for variety chains in 1936 were below those of corresponding months in previous years, and were high again until late 1938.

Among Chicago bankrupts, the average ratio of inventory as a percentage of total net sales was 10 in the retail food field, 43 for men's clothing, 25 for women's clothing, 42 for drugs, 44 for furniture, and 57 for hardware. The averages for insolvent wholesalers and manufacturers were, respectively, 23 and 27 percent.

In retail meat markets in New York, Cleveland, and Chicago,[20] merchants turn their stock of goods, on the average, every 3.4 to 4.8 days. The larger the store, the more frequently is the stock turned.

Neglect of recording inventory is apparent in all analyses of failure. In New Jersey,[21] 39 percent of the enterprises studied had never taken inventory.

Foulke [22] found that the ratio of net sales to inventory in the retail field varied from 2.3 (times, or 320 percent) for men's and women's shoe stores, to 9.8 for women's specialty shops. Men's and boys' clothing ratio stood at 3.5, installment clothing at 7.8. In the wholesale field, men's and women's shoes averaged 5.6, women's and children's shoes, 7.7. Other wholesale ratios included groceries, at 7.5, hardware, 3.9, hosiery, 7.1, women's wear, 19.2, and drugs, 5.3. Among manufacturing groups, diversified ratios ranged from 3.4 for fruit and vegetable canners, to 20.5 for dresses.

Another ratio found of value is inventories to receivables, used in conjunction with sales to inventories. Both are important asset items, but while inventories is a cost item, receivables is a selling value series. With inventory value in the numerator of a fraction and receivables in the denominator, a check as to whether inventories are being accumulated too rapidly is available.

As an example, the American Piano Co., which went into receivership in 1929, had the following ratios of inventories to receivables for the 6 years beginning with 1923: 85, 107, 118, 130, 168, 162. The inventory position then became unfavorable in 1924 and remained so. The index of inventories rose to a peak in 1926, then declined, as follows, beginning with 1923: 100, 105, 114, 146, 128, 94. Thus, although the 1929 inventories had been reduced to 94 percent of the 1923 figure, the relation of inventories to receivables was still unbalanced in 1929.

In reviewing the evidence brought to bear upon this problem, the extent of failure to control overhead costs is impressive. The machinery is complex and each cog must fit and function, or friction will

[19] Stanley F. Teele: "Expenses, Profits, and Losses in Retail Meat Stores," Northwestern Bureau of Business Research, series III, No. 9, 1924.
[20] Horace Secrist: Op. cit.
[21] Domestic Commerce Series No. 54.
[22] Roy A. Foulke: Op. cit.

stop operation completely. The following quotation[23] presents the composite expenditure of retailers:

> Out of every $100 which customers paid to retailers in 1929, about $73, on the average, was paid by the retailer for the goods sold, and $25 or more went for his operating expenses. Of the latter sum, more than $14 was paid out for wages, including as estimated remuneration for proprietors. Of the remaining $11, rent accounted for more than $4 and the remainder of $7 went for light, fuel, supplies, interest, etc.

This composite estimates operating costs at about one-fourth of retailer expenditures. This proportion necessarily varies by retail fields which in some aspects are as different as is a manufacturing concern from a hot-dog stand. This complexity is obscured by composite estimates. The proprietor is in need of very specific guides, and such landmarks can be made available only by careful research and analysis. Dissemination of the results is a problem in adult trade education.

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[23] Twentieth Century Fund: "Does Distribution Cost Too Much?" 1939.

CHAPTER XI

CONTROL OF SALES, OF MARKETS, AND OF PRODUCTS

In the analysis of the relation of life-span to sales, we have noted the survival advantage of the larger volume outlets. Also significant, is the overoptimism of new proprietors in estimating business income, resulting in assumption of unwarranted obligations and the excessive withdrawals for personal use.

SALES VOLUME

In the country as a whole, approximately 64 percent of all retail stores had sales in 1933 of less than $10,000 annually,[1] and these stores accounted for less than 14 percent of the total volume of retail sales. The average sales per small store (those with a volume of less than $10,000) was $3,530, and per large store, $39,656. In the food group, 62 percent had sales of less than $10,000, representing 15 percent of food sales volume. Among druggists, small stores represented 43 percent of the total number and 6 percent of sales.

In 1933, the average sales volume of 2,188 stores of 15 identical variety chains[2] was $154,000. The number of outlets had increased in 1938 to 2,374, and the average sales to $182,000.

In the Chicago study of bankruptcy, it was found that the average (arithmetic mean) sales of failed concerns were in all groups less than the average for the city of Chicago.

Since income of business is primarily from sales of commodities and services, and since each enterprise and its competitors are seeking large volume, there is little to be said regarding the total amount of sales except in post mortem. The potential total demand may be obviously too small to support the number of enterprises desiring to share it.

SALES EFFORT

Misdirected selling effort is basically the result of disregard for market potentials, or a tactical device for retaining the goodwill of customers.

An analysis of sales management problems records many interesting pitfalls to which unsuccessful firms have succumbed.

Cowan[3] illustrates experiences, particularly in the field of meat distribution. Although one concern found that sales volume to country retailers was 128 percent greater per interview than to city stores, the expense attached was 78 percent greater for country stores; in 14 marketing areas, the per capita sales in rural sections were only 25 percent of those in neighboring cities.

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[1] Solon Ayers: A Study of Mortality of Retail Grocery Stores in Austin, Texas; from 1880 to 1932 (University of Texas Master's Thesis).

[2] Stanley F. Teele: Op. cit.

[3] Donald R. G. Cowan: "Sales Analysis from the Management Standpoint," University of Chicago Journal of Business, vol. IX, Nos. 1, 2, 3, and 4, 1936, and vol. X, No. 1, 1937.

In table 112 is summarized the sales experience of a large city meat wholesaler, indicating variations in patronage; in subsequent pages the cost and profit results of similar analyses will be discussed.

TABLE 112.—*Variations in weekly amounts sold to different types of retailers; the experience of a meat wholesaler in a large city*

Weekly amounts sold	Types of retailers							
	Meat		Grocery		Combination		Delicatessen	
	Number	Volume	Number	Volume	Number	Volume	Number	Volume
	Percent	*Percent*	*Percent*	*Percent*	*Percent*	*Percent*	*Percent*	*Percent*
Unsuccessfully solicited	34.3		46.3		35.4		28.5	
Up to $10	15.0	1.8	15.4	3.4	17.1	3.7	33.3	9.0
$10 to $20	9.0	2.6	12.8	11.1	14.7	9.7	14.3	13.8
$20 to $50	20.8	15.9	17.5	31.5	20.0	27.1	9.6	17.5
$50 to $100	9.0	17.6	6.4	25.4	8.8	25.3	14.3	59.7
$100 and up	11.9	62.1	1.6	28.6	4.0	34.2	0	0
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

In the same field, a Pittsburgh [4] study indicated that no retailers purchased meat exclusively from salesmen and that most proprietors preferred to inspect meat at the packers' branch establishment. Kosher and chain outlets purchased most of their volume from packers' headquarters, while the combination grocery and meat outlets preferred purchase by telephone or through salesmen. Almost one-third of the retailers made no purchases on Monday or Saturday. Only 14 percent patronized one packer exclusively, while 64 percent dealt with three or more packers. With small volume in most instances, the cost of merchandising was high.

Three packers' branch houses [5] found their average order approximately $26 for the period 1926–30, as elaborated in table 113. But the tremendous turn-over of customers served, table 114, is another side of the customer problem.

TABLE 113.—*Number of customers, number of orders, and total dollar sales of 3 branch houses for 5-year period, 1926–30*

	Total number of customers served	Total number of orders sold	Total dollar sales	Number of orders per month	Dollar sales per month	Dollar sales per order
Branch house A	925	171, 463	$5, 921, 423	2, 857	$98, 690	$34. 53
Branch house B	510	104, 289	3, 090, 085	[1] 1, 931	[1] 57, 223	[2] 29. 63
Branch house C	1, 007	[2] 300, 493	6, 072, 753	[2] 5, 008	101, 212	[2] 20. 21
Combined	2, 442	576, 245	15, 084, 261	9, 604	251, 404	26, 17

[1] Calculated on basis of 54 sales months, data for first half of 1926 being incomplete.
[2] The number of orders and related figures as stated for this branch house are not comparable with those of the other 2 branches, as this branch used separate sales tickets for beef orders and for provisions. The "per order" figures therefore cannot properly be compared as between branch houses, but probably are comparable as between classes of customers for all 3 branch houses taken together and are used accordingly.

[4] John H. Cover: "Neighborhood Distribution and Consumption of Meat in Pittsburgh," University of Chicago Press, 1932.
[5] Howard C. Greer: "Customer Turn-over Experience of Meat Packing Companies," Journal of Business, Vol. III, No. 3, pt. 2, April 1933.

TABLE 114.—*Customer mortality—percentage lost and rate of customer turn-over*

	Total number of customers served	Number of customers lost in period	Average number active at one time	Number of customers lost in percentage of—		Average rate of custom turn-over
				Total number served	Average number active	
Branch house A	925	660	294	71.3	224	Once in 19 months.
Branch house B	510	354	182	69.4	194	Do.
Branch house C	1,007	671	328	67.1	205	Do.
Combined	2,442	1,685	804	69.0	210	Do.

COST OF SELLING

Cost of making a sale is represented for a wholesaler of packing-house products in a southern city [6] in table 115.

TABLE 115.—*Functional distribution of expenses: A typical wholesale unit, 1929*

	Percentage of total wholesale expense
Order-taking	23.6
Packing and loading	3.8
Handling	2.9
Delivery	12.1
Sales bookkeeping	1.9
Credits and collections	.6
Total variable expense	44.9
Fixed expense	55.1
Total expense	100.0

In illustrating ascertained costs, Cowan cites the case of a wholesale meat distributor who obtained from a retailer—

> one order for three product items and incurred expenses for two interviews, two telephone calls, one delivery, bookkeeping, and incidental services, the total amounting to $0.95. Now, the sales value of the order was $24.37, the goods cost $23.40, and the difference, $0.97, was the gross profit on the transaction. Dealer Smith was a profitable customer, because, after paying the direct cost of serving him during the week, the distributor had $0.02 left for defraying fixed expenses.

A study of two wholesale branch houses of different companies [7] disclosed that orders of one-half of the retail customers were so small as to produce in the aggregate only 4 percent of the total volume, and to create a handling cost ranging from $10 to $35 per $100 of sales. In contrast, 5 percent of the accounts produced one-third of the total volume, and 20 percent produced two-thirds; only for these accounts were handling costs lower than gross profits.

Table 116 suggests that, in the experience of six wholesale meat houses, only sales of $20 or more per week offer opportunity for a net profit.[8] Though only one-third of the customers buy $25 or more weekly, these purchases represent 91 percent of sales volume and only 37 percent of total expenses.

[6] Donald R. G. Cowan: Op. cit.
[7] Howard C. Greer: "The Cost of Handling Small Orders and Accounts," Institute of American Meat Packers, 1928.
[8] Donald R. G. Cowan: Op. cit.

TABLE 116.—*Profitableness of different customers, classified by amount purchased weekly*

[6 wholesale meat distributors, a typical week, 1930]

Amount purchased during week	Percentage of total customers	Percentage of total sales	Percentage of total expenses	Percentage of average sales per customer	Gross earnings per sales unit	Direct expense per sales unit	Net profit per sales unit[1]
Dealers unsuccessfully solicited	27.0	----------	3.9	----------	----------	----------	----------
Less than $5	12.0	0.8	2.1	6.5	$1.50	$2.95	−$1.45
$5 to $10	10.1	1.6	2.8	15.5	1.38	1.92	−.54
$10 to $15	7.3	2.0	2.5	27.4	1.33	1.33	----------
$15 to $20	5.8	2.1	2.3	36.7	1.16	1.16	----------
$20 to $25	4.9	2.4	2.2	49.0	1.09	.97	.12
More than $25	32.9	91.1	37.1	276.6	.76	.44	.32
Average	100.0	100.0	52.9	100.0	.80	.57	.23

[1] Gross earnings minus direct expenses only.

LOCATION

In our earlier industrial history, and too frequently in current experience, business locations were chosen in the area in which the new proprietors, or promoters, lived, without consideration of the many important elements necessary to success. With a concentrated population and small-scale industry, this neglect was of minor importance, since factors of production and distribution were readily available. But with population migration and exhaustion of resources, location has become an increasingly important consideration.

Prime factors in the past have been raw materials, power, labor, capital, markets, transportation, and military defense.[9] Negative elements in management's consideration were labor organizations and taxation.

In recent years certain artificial factors have developed, such as special inducements offered by political jurisdictions—including tax-free status, land, plant, and other capital contributions—and special obstacles in the nature of barrier regulations—prohibitions to manufacture, or the flow of trade, or movement of persons.

In the process of spreading manufacture geographically, Thorp[10] lists three steps:

1. Development of backward areas and decline of highly developed areas.
2. Development of rural sections and decline of urban.
3. Break-down of local concentration in historical centers of specific industries.

Advantages of this procedure are suggested as follows:

1. Saving in freight hauling.
2. Reducing delay in shipping.
3. Relieving the dependence of areas upon single types of manufacture or activity for livelihood.
4. Lessening of violent depressions and of excited prosperities due to diversification of industry.

An example of problems faced by a new manufacturer and limiting his chance of survival is found in the glass industry.[11] The two most important factors are availability of fuel and raw materials; skilled labor is of next importance. Fuel is usually one of the largest expense items. Although any sand may be used, the purer quality produces

[9] Eliot B. Mears: "Strategy in Industrial Location," Harvard Business Review, autumn. 1937, vol. XVII, No. 1.
[10] Willard L. Thorp: "The Changing Structure of Industry"; in Recent Economic Changes in the United States, vol. I, pp. 206–216, 1929.
[11] Metropolitan Life Insurance Co., Policyholders Service Bureau; "The Glass Industry: Plant Location Factors."

the clearer glass; this limits location to nine States. Limestone is a secondary raw material. Methods of production range from automatic machinery to primitive hand methods. At present there is a considerable overcapacity in the industry.

Changes in the welfare of an industry are illustrated by the decline of flour milling in Minnesota.[12] The Northwest was surpassed in output by the Southwest in 1921 and Minneapolis yielded first place as a milling city to Buffalo in 1930. The important causes may be outlined as follows:

1. Superiority in quality of spring wheat was lessened by—
   (a) Decline in average quality of northwestern wheat.
   (b) Substitution of choice hard wheat for soft winter wheat in the Southwest.
2. Reduced production of spring wheat in the Northwest due to substitution; to territorial limits of mountains on west, Canadian border on north, and latitudinal boundary in south; invasion of weeds and disease.
3. Changes in distribution. The shift from carload to less-than-carload distribution of flour interposed jobbers between millers and retailers and small bakers; this removed direct touch of millers with retailers, increased importance of cost and price. Large milling companies obtained volume at expense of small enterprises. Chain-store buyers shopped around, purchasing for their use under private brand.
4. Consumption per capita of wheat flour declined. Bakeries were substituted for home production.
5. Transportation: Change in freight rates to the advantage of Buffalo, which also is closer to the market. Milling-in-bond privilege in export gave advantage to Buffalo in manufacturing from Canadian wheat.

Measures of the location of manufacture have been suggested [13] in the form of indexes, as follows:

1. Density of employment; wage earners per 1,000 population.
2. Geographical density: wage earners per square mile of land area.
3. Percentage of wage earners of urban population.
4. Employees per establishment.
5. Value added by manufacture per employee.
6. Percentage ratio of wages and salaries to value added by manufacture.
7. Index of concentration: a composite index of wage earners and population.

The importance to meat wholesalers of the location of their headquarters [14] is illustrated in table 117. The advantage in total volume to wholesalers in large cities is apparent. It was found that each wholesaler's volume does not vary in proportion to the population served. Competition in large cities tends to be more severe; in addition, the per capita sales in smaller cities are greater due to local dominance and to the proportion of the population served in neighboring areas. Despite smaller and scattered population, expense per hundredweight is not much greater in the smallest communities than in the largest, while gross earnings per hundredweight are considerably higher in the towns. And, finally, net earnings tend to be less in large cities.

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[12] Victor G. Pickett and Roland S. Vaile; "The Decline of Northwestern Flour Milling," University of Minnesota Press, 1933.
[13] F. B. Garver, F. M. Boddy, and A. J. Nixon: "The Location of Manufactures in the United States, 1899–1929," 1933.
[14] Donald R. G. Cowan: Op. cit.

TABLE 117.—*The size of the headquarters city and its relationship to sales volume, expenses, and earnings*

[78 meat wholesalers—a typical year]

	Population of headquarters city		
	Less than 100,000	100,000 to 500,000	500,000 and over
Number of wholesalers	43	26	9
Average population:			
Headquarters city	47,000	219,000	1,821,000
Selling area	112,000	281,000	2,124,000
Percentage of population outside of headquarters city	58	22	12
Index ratios:			
Volume per wholesaler	46	108	788
Sales per capita	414	385	371
Gross earnings per hundredweight	$1.11	$0.95	$0.92
Expense per hundredweight	$1.10	$1.05	$1.01
Net earings per hundredweight	$0.01	−$.10	−$.09

References to the cases of failed concerns indicate the importance of the site factor. Again, information is available principally for retailers, where pedestrian traffic and transportation play such large factors for most types of outlets.

Almost 6 percent of the Chicago bankrupts [15] had such inauspicious locations as to make success highly improbable. In few instances had any effort been made in advance to evaluate the location. Some proprietors had been influenced by an offer of space for a period free of rent. One independent grocer in order to enlarge his space changed location to a site between two chain grocers. He recognized the competition involved but hoped for patronage with the development of antichain propaganda.

Twenty-eight of the 487 New Jersey [16] cases studied failed due to location. A bankrupt who had been successful in another location is quoted, "People forgot me, although I moved only around the corner."

The extent of congestion of stores in certain neighborhoods is illustrated by a Jewish area in Pittsburgh,[17] where 26 food outlets within 4 blocks sought the kosher trade and 5 others served from tributary streets. Chain stores have not penetrated the area, and the oldest meat market is proud of its life span of 5 years.

In addition to congestion, pedestrian traffic, and transportation facilities, there are other problems of location that failed retailers have overlooked.

In one section of Chicago 23 percent of retail store sites were vacant over a period of approximately 18 months. All of these locations had previously been occupied and landlord competition was so severe that retail proprietors were offered liberal inducements to establish business enterprises. In continuous flux were luggage, radio, sporting goods, cigar, painting and decorating, and lingerie and hosiery stores.

The opening of supermarkets in outlying areas tended to draw, at least temporarily, patrons who shopped by automobile. The extensive advertising of "downtown" stores left some neighborhood proprietors servicing convenience goods purchasers.

Closing of industrial plants, or partial reduction of employment, removed much of the advantage of stores dependent upon industrial

[15] John H. Cover: Business and Personal Failure and Readjustment in Chicago, University of Chicago, August 1933.

[16] U. S. Department of Commerce, Domestic Commerce Series No. 54.

[17] John H. Cover: "Neighborhood Distribution and Consumption of Meat in Pittsburgh," University of Chicago Press, 1932.

workers who were accustomed to shop and carry purchases to their homes.

There are many instances of parlor stores, the use of front rooms of a home for business purposes; frequently, the wife adds the clerking involved to her regular responsibilities. The turnover is high, since such outlets frequently are established to tide over periods of unemployment or of reduced income. The extent of this type of establishment in Poughkeepsie [18] is shown in table 94.

An item of importance in some neighborhoods is the race or nationality of the proprietor. Closely knit nationality groups prefer a dealer of their origin, and another would have little success in these preferential areas.

CHANNELS OF DISTRIBUTION

A dynamic statement of the "battle of the channels" of distribution is adapted from Thorp:[19]

> * * * for any particular raw-material-to-product sequence, there is nothing inevitable with regard to the location of the various functions within any existing pattern of economic enterprises. The entire process may be under a single control, as in the case of the farmer who optimistically sends eggs direct to customers by parcel post. It may be roundabout and subdivided among at least a dozen intermediaries, as in the case of transforming raw cotton into a house dress. Often there are many channels all in simultaneous operation—a single manufacturer of rubber tires may sell to wholesalers, to mail-order houses, to a filling station chain, to large fleet buyers, to independent retailers through his own wholesale branches, to his own retail stores, and direct to his own employees.
>
> A consideration of changing distribution channels must record not only the continued contest among the various routes to the consumer but also the shifting location of functions along the different channels. Advertising, for example, may be undertaken by the manufacturer, by a cooperative arrangement between him and the retailer, or by the retailer himself. Inventory may be carried at any of several points. The function of determining the retail price may, through the operation of resale price maintenance contracts, be shifted from the retailer to the manufacturer. In the case of State laws establishing minimum prices or mandatory mark-ups, even State legislatures have taken a hand in what has historically been a function of the retailer.
>
> The complicated character of present-day distribution is the result of the many interrelated forces which make our economic system dynamic. Since the operating unit of retail trade can be no larger than its trading area, the growth of cities and the development of automobiles and roads have been fundamental to the rise of large store units. Mass production has created national markets while the development of large-unit products, particularly the so-called consumers' durable goods, has encouraged many specialized types of selling.
>
> Merchandising has appeared as an art and competitive pressure resulting from excess productive capacity has made "selling" the concern of every businessman. Not only have economic forces been exceedingly active but the various interested parties engaged in the struggle for survival have turned to the authority of government for aid, and more and more the problems of distribution are becoming the concern of our legislators. During the last decade, it is probable that more legislation relative to the processes of distribution than of manufacturing has been added to the statute books and survived court scrutiny. The battle of the channels is a national issue.

A condensed summary [20] of current movements is recorded as follows:

> The struggle for power, or for existence, in distributive enterprise parallels the contests of a few generations ago in manufacturing. In order that the significance of this struggle may not be underestimated, it is important to list some of the

[18] R. G. Hutchinson and A. R. and Mabel Newcomer: "Study in Business Mortality," American Economic Review, vol. XXVIII, No. 3, September 1938, pp. 497–514.

[19] Willard L. Thorp: "Changing Distribution Channels," American Economic Review, vol. XXIX, No. 1, Supplement, March 1939.

[20] John H. Cover: "Changing Distribution Channels: The Initiative Taken by Distributors Themselves," American Economic Review, vol. XXIX, No. 1, Supplement, March 1939.

related factors and occurrences: Rapid changes in channels of distribution, business organization, and business practices; high costs of merchandising; alinement of forces upon a national basis for obtaining special advantages and protection; use of legislation as a competitive or security device; expansion of monopoly devices (laws, patents and trade-marks, and trade association activities) in fields regarded as desirably competitive (these devices tend to control price, quality, and conditions of sale); potential restricting effect upon consumer purchasing power; prospective increase in unemployment; competition of State and Federal governments over trade and commerce jurisdiction.

An enterpriser should consider the importance of established distribution channels, the possibility of their change, and the absorption of functions in the process. It is part of his competitive problem. Some cooperative purchasing retailer groups,[21] for instance, combining to gain the economies of mass purchasing, have been unable, as a group, to meet the price competition of chains and some other retailers due to the inclusion in membership of weak independent proprietors who proved a burden to the organization.

The significance of credit financing in many distributive fields, makes it difficult for an enterpriser to break away from a channel, though a shift might strengthen his competitive position. Similarly, the agency-relation frequently used ties the representative to an established procedure.

COMPETITION

A complex factor frequently credited as the principal deterrent to the successful operation of an enterprise is competition. In some instances, it is apparent that an excess of firms in a particular field or area is meant. In others, recurrent or continued price wars are involved. Again, branded products, or patented procedures, or special services or terms, are the instruments.

The chain store is under attack by the independent merchant organizations in some fields, as the mail order business and department store were previously on the figuring line. Each new channel of distribution becomes a competitive device resented by the existing trade outlets.

Emphasis is placed upon a distinction between fair and unfair competition, ranging from monopolistic concentration of control to specific trade practices. A counterdevelopment by organized groups has resulted in a series of enabling statutes permitting resale price control, regulation of sales below cost, prevention of price discrimination, discriminatory taxation, and a series of special protective devices referred to as trade barriers.

In estimating the place of competition in the bankruptcy of Chicago concerns, the general conclusion is as follows:

> Among the environmental factors, chain-store competition, involving 9 percent of the failures, was dominant. The chain store in most instances has been characterized by lower costs (including rentals), reduced consumer prices of many commodities, and more modern business facilities. However, it is not apparent that the chain store as an institution is eliminating the best of the individual proprietors. It would appear that most of the failures occurred to marginal firms, parasitic in nature, which could remain in business only so long as not challenged by pressure of economic forces or of modern business methods.
>
> In the price-competition category are principally those affected by the liquidating sales of competitors failing in business or attempting to raise cash to stave off failure.

[21] John H. Cover: Retail Price Behavior, University of Chicago Press, 1935.

From a study of New Jersey [22] bankruptcies, it was concluded that "in very few cases could it be said that competition was the cause of failure."

Again in the case of the St. Louis [23] drug stores, competition played a general, but not a primary role:

Twelve of the thirty druggists stated that competition was a cause of failure. In only one case did this seem to be an apparent cause. The principal creditors seemed to have had utmost confidence in the owner who failed and were in complete accord as to the cause of failure in this particular case, stating that chain-store competition was the only reason. A large chain-store organization had a very attractive store directly across the street from the druggist who failed and there did not seem to be sufficient business in the immediate neighborhood to support two stores.

A summary background applying to Boston [24] is of more general implication:

Competition determines the fate of industries and the firms that survive within an industry. The most efficient and well-operated concerns generally survive. During the last decade, a multitude of firms have been eliminated during the process of the revolutionary changes that have taken place in practically every industry.

Many concerns have broadened the sphere of their activities, numerous manufacturing firms now own retail outlets, and a great number of wholesale establishments are at present engaged in manufacturing and retailing. Examples of retailers who have extended their activities to include the functions of manufacturing and wholesaling are becoming numerous. The growth of cooperative organizations in practically all lines of trade has been rapid. New products have been created, new methods devised, and new types of businesses established to meet the changing conditions. Many concerns are now manufacturing and selling merchandise which even a few years ago would have appeared to be an unprofitable and unwise procedure.

In practically every phase of commercial activity, expansion has extended beyond present needs, and the problem of securing sufficient business to provide a profitable existence is difficult. The entrance of many unqualified and inefficient business venturers into commercial activities has accentuated the condition.

Competition serves to eliminate the inefficient and unqualified from business, but unfortunately their places are filled by others equally inefficient and unqualified. No effective method of selecting business enterprisers has yet been created, although there is sufficient evidence to prove the need. Thousands of business ventures are launched by optimistic individuals without a proper valuation of the existing competition or their own abilities. The unnecessary duplication of retail stores—which fail in larger numbers, comparatively, than any other type of enterprise—is widespread and prevents many efficiently managed concerns from making a legitimate and just profit.

There are many examples of several stores striving to secure a share of business in a trading area whose total available business is insufficient to warrant the existence of more than one store. If four drug stores are within one block of each other, each endeavoring to obtain all of the available volume of business, which is inadequate to support any two of them (a not uncommon occurrence), the advent of another is fraught with danger to all, and to succeed, the newcomer must be well fortified with resources and endowed with unusual abilities. Generally, it is the newcomer who fails to survive, but frequently the old, established firms, struggling with antiquated methods and relying on past achievements, fail to meet the pace set by a new and aggressive competitor utilizing modern methods in the operation of his business.

Lack of sufficient ability, resources, and opportunity to overcome existing competition is a frequent cause of failure, but in many other cases the inability of certain established concerns to match the progressive activities of new and better qualified competition is a cause of failure.

[22] U. S. Department of Commerce, Domestic Commerce Series No. 54.
[23] U. S. Department of Commerce, Domestic Commerce Series No. 59.
[24] U. S. Department of Commerce, Domestic Commerce Series No. 69.

PRODUCTS

In a previous discussion of merchandising cost problems, the significance of quantity purchases by retailers was emphasized.

The problem of lines to be handled faces the merchant, and is related to his market location, credit, costs, and other factors. In the development of N. R. A. retail codes, a controversy arose between representatives of the retail drug and grocery trades over assignment of soap. Both claimed proprietary interest in this product. Currently, many grocers sell cosmetics and toiletries while some druggists stock packaged foods and beverages and even fresh fruits.

As illustrative of the problems of selling families of products, table 118 gives the experience of four meat wholesalers [25] in 1932. Selection of customers is involved. It was estimated that the elimination of 51 percent of their customers would reduce the sales of product A by only 4 percent, but of product I by 25 percent. Concentration upon large dealers might recoup the loss upon the first six products, and might even increase the wholesalers' total volume, but the sales of products G, H, and I might thereby be reduced considerably.

The production of joint products in the meat industry is inescapable. The beef carcass yields four quarters, and the quarters provide smaller specific cuts commonly demanded by the consumer. The wholesaler must dispose of the whole carcass; the consumer has definite preferences.

TABLE 118.—*Proportions of different products sold to small and large buyers—4 wholesalers, 1932*

Products	Small (percentage)	Large (percentage)
A	4	96
B	6	94
C	7	93
D	8	92
E	9	91
F	9	91
G	14	86
H	20	80
I	25	75
All products	9	91
Customers	51	49

Consumer preference is illustrated by the tenets of religious creed. In addition to pork, kosher markets in Pittsburgh [26] do not handle calves' liver and dried beef. This selectivity tends to add to the price which the consumer must pay for desired cuts. Therefore, kosher shops charged the highest city prices on round steak, veal loin chops, lamb shoulder chops, beef rib roast, beef chuck roast, jumbo bologna, beef liver, and beef brisket boil. On the one hand, the retailer in a Jewish area is aware of the field of customer demand, on the other he is faced with high product costs; if his market is a neighborhood of low income, his problem of existence is further aggravated.

Failure of an effort to sell one product in combination with others is discussed by Cowan: [27]

[25] Donald R. G. Cowan: "Sales Analysis from the Management Standpoint," University of Chicago Journal of Business vol. IX, Nos. 1, 2, 3, and 4, 1936, and vol. X, No. 1, 1937.

[26] John H. Cover: "Neighborhood Distribution and Consumption of Meat in Pittsburgh," University of Chicago Press, 1932.

[27] Donald R. G. Cowan: Op. cit.

Market preferences are as important as consumer preferences in choosing products to be sold in combination with others. An interesting example is provided by the experience of a manufacturer who produced a fine quality of cream cheese and branded it "Excel." Although sold along with other perishable and semiperishable foods, this product was a failure for the following reasons: (1) The brand name "Philadelphia" is so well established that consumers regard it as a special type of cheese. Retailers might be willing to handle Excel Philadelphia Cream Cheese, but not Excel Cream Cheese. (2) Although the price of the Philadelphia brand is higher, its producer gives excellent service, taking back all of this perishable cheese not sold promptly during warm weather. (3) Because the total consumption of cream cheese is small, the retailing of a second brand is uneconomical. This experience illustrates the danger of reasoning, without investigation, that an almost clear profit may be gained by requiring the present sales force and facilities to sell and deliver an additional product.

In table 119, Cowan summarizes the results of a product-sales study of 15 wholesalers. He comments as follows:

In this same study expenses at 15 wholesale establishments were allocated to 9 product groups, and the unit expenses of the highest-cost group were found to be 3 times those of the lowest-cost group.

There are several reasons for believing that, in this study, the careful application of these methods gave dependable results. By regrouping of the product expenses according to the triple classification used in the correlation study, somewhat similar unit expenses were obtained. Second, gross earnings, which are established competitively on each of the nine products, varied above or below average earnings in approximately the same manner as the corresponding selling costs varied around average selling costs. Third, the method took into consideration all the known elements in wholesaling each product, and the resulting differences in expenses were not due to arbitrary manipulation. Many expenses belonged entirely to each product while others were divided on such bases as space, time, volume, and value. The division of salesmen's time was the most complicated and, at the same time, the most important allocation because it gave effect to the quantities and combinations of different products sold to different classes of retailers. Although nearly the same time and expense were required in selling an item of each product, there were extreme variations in volume per item and per interview which * * * were clearly related to expenses as finally allocated.

Intricacies of the market, of the product, and of the sales problems facing the business proprietor are contained in the references just presented. It is so frequently the experience of the manager that his errors are apparent only after he has reaped their harvest, that his records, bitter reminders of these miscalculations, are destroyed. But only through accumulation, coordination, and comparison of such records can our successors have the advantage of past experience.

TABLE 119.—*Relationship of product expense to volume per item and per interview*

[In percentages of average]

Ranked product-groups	Volume per item	Volume per interview	Product expense
C	186	150	65
A	178	219	79
F	158	151	64
B	119	109	81
E	77	82	89
G	63	56	121
D	52	56	98
H	52	56	110
I	15	21	193

262652—41—No. 17——10

CHAPTER XII

CREDIT AS A FACTOR IN BUSINESS MORTALITY [1]

Though credit is a function of sales and of business cost, it is of sufficient importance in the experience of failed enterprises to warrant separate treatment.

In considering capital problems earlier in this section, the sources of funds of bankrupts and the types of credit were examined. In examining assets and liabilities of failed concerns, reference was made to receivables, as well as to credit sources.

CREDIT RISKS

Important qualifications for a credit risk are suggested from the study of insolvent drug stores of St. Louis.[2]

1. *Adequate accounting records, as bases for a knowledge of the cost of doing business and of the financial status of the enterprise.*—It is suggested that little credence should be given to financial statements submitted to creditors by debtors unless supported by an adequate set of books.

2. *Sound financial structure.*—Lack of capital in the conduct of business was discussed previously. In one drug store failure in St. Louis, the proprietor started business without any capital of his own, and with an indebtedness of $6,000.

Financing of a business at exorbitant interest rates is a certain prelude to insolvency. In one instance, the proprietor paid 36 percent interest on $7,250 borrowed to start in business. The total capital was $8,000, and in the year prior to failure, sales aggregated $14,000. Interest alone exceeded profits.

Three St. Louis druggists endorsed notes for each other at a time when all were actually insolvent.

Insufficient working capital results in inability to take advantage of trade discounts and adds to the cost of doing business.

3. *Progressive and experienced management*, based upon training, experience, and personal aptitude and appearance, is a factor elaborated previously.

4. *Efficient and honest store personnel.*—Dishonest or careless and ineffective employees are serious detriments to success and the basis of a number of failures.

5. *Operating costs.*—Excessive costs are illustrated by St. Louis drug experience. The average rent paid by the insolvent firms was 10.6 percent of net sales, and by successful firms, 4.7 percent.

6. *Store location.*—Failed enterprises had not considered, in choosing their store sites, the potential number of customers (500 families is suggested as the minimum patronage), the amount or stability of

[1] For a discussion of the capital and credit problems of small business in general, not only of those that fail, see pt. III below.

[2] U. S. Department of Commerce, Domestic Commerce Series No. 59.

customer income, the employment experience of the neighborhood, the number and strength of competitors, or the history of predecessors in that location.

7. *Antecedent information.*—The history of a firm and of its proprietor are important in gaging the present credit risk. Particularly should investigation be made of previous failures, fraud, fire losses, cancelation of contracts, heavy personal withdrawals from business, inaccurate financial statements, and gambling proclivities.

Comparison of two similar firms manufacturing cotton textiles,[3] one insolvent and the other successfully operating, illustrate vital differences in strength. The failing concern had $27,500,000 of assets, the going concern, $23,500,000. They were competitors located in New England, and at one time had about the same volume of sales.

TABLE 120.—*Comparison of insolvent and successful firms—cotton textile industry*

Dec. 31, failed concern			Type of ratios	Oct. 31, successful concern		
1922	1923	1924		1922	1923	1924
105	99	39	1. Current assets to current liabilities	170	160	160
74	71	20	2. Quick assets to current liabilities	72	65	58
33	55	17	3. Sales to fixed assets	68	147	126
178	378	360	4. Sales to inventories	179	232	238
82	157	58	5. Sales to receivables	340	400	567
42	73	30	6. Sales to net worth	53	103	95
88	90	103	7. Net worth to debt	334	216	257
80	75	58	8. Net worth to fixed assets	130	142	133
46	41	147	9. Inventories to receivables	190	172	238
−13.0	−5.7	−18.2	10. Net profits to net worth	−6.5	+10.8	−4.3
36.4	32.7	8.8	11. Current assets to total assets	39.1	50.7	44.8
59.4	63.1	86.1	12. Fixed assets to total assets	59.4	48.2	54.1
4.1	4.1	5.1	13. Other assets to total assets	1.5	1.0	1.0

Reference to the current and quick ratios, table 120, suggests that neither company was a favorable risk, since the ratios are below the 200 and 100 percent standards, respectively, each year. The sales ratios of the failing concern are particularly interesting, Nos. 3 and 6 showing poor condition, but Nos. 4 and 5 indicating strenuous managerial efforts at improvement. The sales to receivables ratio, No. 5, suggests success in reducing the proportions of their own credit business.

In 1928, almost 79 percent of the 1,371 Philadelphia[4] independent retail grocers extended credit to customers. The strictly cash stores accounted for only 15 percent of the total dollar volume of sales. Credit stores handled 47.1 percent of their total volume on credit; the highest proportion of credit sales was recorded for stores with an annual volume of $250,000, or more each.

CREDIT LOSSES

Credit losses averaged 1.5 percent of credit sales, or 0.7 percent of total sales for the credit stores as a whole. Losses varied inversely with the size of stores; the range was from 8.3 percent of credit sales

[3] Ralph C. Epstein: "The Rise and Fall of Firms in the Automobile Industry," Harvard Business Review 2, January 1927.

[4] Ralph C. Epstein: The Automobile Industry: Its Economic and Commercial Development, McGraw-Hill, Inc., 1928.

for stores with annual sales of less than $5,000 to 0.2 percent for those with $250,000 or more. The loss dropped below 1 percent of credit sales for the stores with volumes exceeding $50,000, but with less than $100,000.

In contrasting bankrupt stores with going concerns, it was found that the failing group extended proportionately twice as much credit as solvent enterprises of the same size.

Failing business concerns in New Jersey [5] in 1929 and 1930, suffered credit losses averaging 7.2 percent of credit sales, or 5.3 percent of total sales. Installment credit losses averaged 17.1 percent of installment sales.

Twenty-six contractors has made 36.9 percent of their total sales on open credit and 56.6 percent in the form of installment credit. Credit losses were reported for 18, losses on open credit averaging 16.5 percent of total open credit extended, and instalment losses, 28.8 percent of that category. Plumbing and heating contractors were particularly heavy losers.

Retail radio stores lost 16.6 percent of their open credit, and 3.6 percent of their installment credit advances. Almost 4 percent of the radio business was done on credit. Automobile dealers suffered a loss of 11.7 percent of their open-book credit, and 9.5 percent of their installment credit. Eighty-four percent of their business had been transacted on credit.

It is surprising that the furniture stores with 98.9 percent of their business on credit lost only 3.6 percent of the open credit sales, and 9.6 percent of installment sales. However, since repossession of goods from delinquent customers frequently yielded saleable values, the loss was modified.

The retail average percentage loss on open credit was 4.8 percent and on installment credit, 6.5 percent.

The average for wholesaler bankrupts were as follows: on open credit, 10.8 percent; on installment credit, 5.6 percent.

A comparison of average bad-debt losses of 1,077 Philadelphia [6] and 416 Louisville [7] independent retail grocery stores is given in table 121.

TABLE 121.—*Average credit losses of Philadelphia and Louisville grocers, 1928—credit losses as percentage of credit sales classified by amount total sales*

Total annual sales	Number of stores		Percentage loss of credit sales	
	Philadelphia	Louisville	Philadelphia	Louisville
Less than $5,000	150	42	8.3	5.6
$5,000 to $9,999	201	51	6.0	2.9
$10,000 to $24,999	497	165	3.0	2.0
$25,000 to $49,999	153	111	1.6	1.0
$50,000 to $99,999	52	36	.9	.5
$100,000 and over	24	11	.2	.3

The extent of the divergence of experience of bankrupt firms from the general experience is emphasized in table 122, comparing the

[5] William A. Rothmann: "Business Births and Deaths," Dun's Review, June 1937.
[6] Robert G. Rodkey: State Bank Failures in Michigan, Michigan Business Studies, vol. VII, No. 2, Univ. of Mich. 1935.
[7] Twentieth Century Fund: Does Distribution Cost Too Much? 1939.

credit losses of Boston [8] bankrupts with those ascertained through the Department of Commerce national credit survey.

TABLE 122.—*Bad-debt losses as percent of total credit sales*

Business	Bankrupt firms	All firms
Manufacturers	3.3	[1] 0.[illegible]
Wholesalers	3.8	1.[illegible]
Retailers (merchandise)	6.4	} [illegible]
Retailers (service)	14.5	}
Real estate agents or dealers, builders, and contractors	6.7	(2)
All groups	5.6	(2)

[1] Computed on total net sales.
[2] No comparable figure available.

Among Chicago retail bankrupts,[9] credit extension was a minor problem, except in the furniture business, but even there the percentage of credit sales averaged 38 percent as compared with 69 percent for solvent concerns. Cash sales approximated the following percentages of total in various fields: Wholesale, 55; manufacturing, 66; food retail, 80; women's clothing, 89. Other retail groups recorded 92 percent or more.

Credit losses ranged as percentages of credit sales from 19 for manufacturers to 56 for restaurants, but as percentages of total sales, from 4 for restaurants to 12 for wholesalers.

A study of the experience of three packing houses branch offices in the Chicago [10] area disclosed that about 6 percent of the customers, for the period 1926–30, were responsible for losses on uncollectible debts, and that the average loss was $1.30 per $1,000 of sales, or 1.3 percent.

TABLE 123.—*Number and amount of bad debt losses*

[3 branch houses—5-year period]

	Total number of customers	Total dollar sales	Number of bad debt losses	Bad debt losses in dollars	Percent of customers producing bad debt losses	Bad debt losses per $1,000 of sales
Branch house A	925	$5,921,423	55	$6,696	5.9	$1.13
Branch house B	510	3,090,085	17	4,520	3.3	1.46
Branch house C	1,007	6,072,753	74	8,469	7.3	1.39
Combined	2,442	15,084,261	146	19,685	5.9	1.30

As disclosed in table 123, a large proportion, both of number and of amount of loss, occurred among new customers. Almost 60 percent of the losses and 25 percent of the amount occurred within the first 6 months of patronage. The corresponding proportions for the first year were 71.2 and 65.7 percent. This experience tallies with the high infant mortality rate of retailers.

[8] Industry, January 1939.
[9] John H. Cover: Business and Personal Failure and Readjustment in Chicago, University of Chicago, August 1933.
[10] Franklin W. Ryan: "Municipal Control of Retail Trade in the United States," Supplement to National Municipal Review, December 1935, vol. XXIV, No. 12.

TABLE 124.—*Number and amount of bad debt losses according to length of service life*

Length of service life [1]	Number of bad debt losses	Percentage of total number of losses (cumulative)	Bad debt losses in dollars	Bad debt losses per $1,000 of sales	Percentage of total losses in dollars (cumulative)
1 to 6 months	87	59.5	$4,911	$18.50	24.9
7 to 12 months	17	71.2	8,023	17.60	65.7
13 to 18 months	13	80.1	1,153	2.80	71.6
19 to 24 months	9	86.3	1,172	1.60	77.5
25 to 30 months	3	88.3	758	1.10	81.3
31 to 36 months	3	90.4	1,023	1.70	86.5
37 to 42 months	7	95.2	2,062	2.60	97.0
43 to 48 months	2	96.6	150	.10	97.8
49 to 54 months	2	97.9	364	.10	99.6
55 to 60 months	3	100.0	69	----------	100.0
Combined	146	----------	19,685	1.30	----------

[1] That is, within the 5-year period covered by this study.

Though the aggregate losses are greater among purchasers of large quantities, the number of losses and the loss per $1,000 of sales are larger among customers with small patronage. Relevant to the summary in table 124 are the comments upon specific experiences:

In spite of the fact that one large customer alone was responsible for almost 20 percent of all the bad debt losses sustained by the three branch houses in the 3-year period, and that five others produced another 20 percent of the losses, there was no group of customers buying over $200 per month which had bad debt losses of over $2 per $1,000 of sales. No packer wants to lose $3,750 on a single account, but it is probably no worse to take a loss of that amount on the business of a group of customers whose total purchases aggregate over $3,000,000 than to take losses totaling $800 on the business of a group of customers whose aggregate purchases amount to less than $150,000.

The influence of the type of business is apparent in table 125.

TABLE 125.—*Customer characteristics according to type of business*

Type of business	Number of customers	Average purchases per customer	Size of average order	Average rate of turnover (months)	Bad debt losses per $1,000 of sales	Percentage of customers satisfactory
Meat markets	514	$13,369	$27.38	24.3	$1.30	67
Combination meat and grocery stores	489	11,150	24.46	28.2	.30	66
Delicatessens, groceries, and other food shops	479	661	11.80	11.8	5.50	27
Restaurants, etc	222	1,746	21.82	16.4	10.27	26
Schools, hospitals, institutions	48	8,651	34.97	31.1	.40	53
Bakeries	182	2,952	27.27	23.7	1.70	58
Laundries and cleaners	45	496	49.35	20.1	.20	18
Jobbers	91	10,158	54.15	22.3	1.00	54
Byproduct dealers	10	2,753	14.73	23.5	----------	70
Miscellaneous and unclassified	362	353	18.78	----------	4.10	16
All combined	2,442	6,177	26.17	19.1	1.30	45

The first two groups of customers, meat markets and combination meat and grocery stores, make purchases averaging twice the per-customer patronage of all customers, and, in addition, their service-life is about one-third longer than the average of all stores. Deemed unsatisfactory, and excluded from the last column, were customers who bought no more than $150 of merchandise in any 6-month period,

or who failed to buy for more than two consecutive 6-month periods. The bad-debt losses of the restaurant group were particularly high.

For a comparison of customers by size, the number of full-time employees has been used as criteria: Small, less than two employees; medium, two or three; large, more than three. The customer experience is summarized in table 126.

TABLE 126.—*Customer characteristics according to size of store*

Size of store	Number of customers	Average purchase per customer	Size of average order	Rate of customer turnover, once in—	Bad debt losses per $1,000 of sales	Percentage of customers satisfactory
				Months		
Meat markets:						
Large	130	$30,241	$35.64	31.8	$1.28	75
Medium	211	10.157	22.60	24.6	1.18	71
Small	173	4,608	16.73	18.7	1.96	43
Combination meat and grocery stores:						
Large	90	28,890	33.48	38.5	11	83
Medium	161	11,528	22.01	30.4	.74	71
Small	238	4,186	17.06	22.7	1.50	56

It is thought that the superior showing of combination stores as to life span and bad-debt losses may be due to size, since they have both grocery and meat departments.

"Few customers whose first-month purchases are less than $50 ever amount to anything" is a summary related to table 127.

TABLE 127.—*Customer characteristics according to size of first-month purchases*

Size of first-month purchases	Number of customers	Average purchases per customer	Size of average order	Rate of customer turn-over; once in—	Bad debt losses per $1,000 of sales	Percentage of customers satisfactory
				Months		
Less than $25	821	$491	$13.34	12.4	$2.25	14
$25 to $50	338	962	16.19	16.6	2.13	31
$50 to $100	317	2,227	18.04	19.7	1.39	48
$100 to $200	307	4,252	20.99	22.5	.89	65
$200 to $300	164	8,322	22.28	25.0	1.55	73
$300 to $500	168	9,653	23.89	26.6	1.46	81
$500 to $600	210	17,401	25.68	29.5	.82	82
$1,000 to $2,000	95	41,848	31.48	37.6	2.07	84
Over $2,000	22	87,002	54.95	39.2	.09	82

Of the 821 customers purchasing less than $25 the first month, only 111 bought enough during the 5-year period to justify the term satisfactory. The aggregate purchases of this group averaged less than $500, with an average order of $13.34. Both the customer turn-over and losses are high.

A chain-independent store comparison appears in table 128. The large debt loss ratio of chains is attributed to the failure of one chain system, causing a substantial loss to one branch house.

TABLE 128.—*Chain stores and independent markets compared*

	Number of customers	Average purchases per customer	Size of average order	Rate of customer turn-over; once in—	Bad debt losses per $1,000 of sales	Percentage of customers satisfactory
MEAT MARKETS						
Chain stores:				*Months*		
Individual accounts	111	$14,016	$28.93	22.1	$3.40	69
Central buying	14	35,407	30.78	32.6	10	71
Combined	125		29.36		2.63	69
Independents	389	12,392	26.62	24.6	.70	67
All markets	514	13,369	27.38	24.3	1.30	67
COMBINATION MEAT AND GROCERY STORES						
Chain stores:						
Individual accounts	25	26,917	59.94	29.5	(1)	72
Central buying	8	16,228	5.75	32.2	(1)	75
Combined	33		23.76		(1)	73
Independents	456	10,196	24.58	28.1	.50	66
All markets	489	11,150	24.46	28.2	.30	66

[1] None.

Records inadequate for control of credit extension were common to many failing enterprises. Perhaps the extreme of laxness is represented in a Pittsburgh neighborhood, as indicated in the following quotation: [11]

> Typically, records are of the "single pass book" variety, the purchase being recorded by the sales person in a small book which is then given the customer for safekeeping. One of the retailers uses a modern calculating machine for adding up the sales in the "single pass book." Should the customer mislay the book, there would be no duplicate record of purchase.

THE CREDITOR AND INSOLVENCY

Though credit is an important instrument of successful business, it is also a factor in insolvency. There is competition in granting as well as in seeking it. It may prove the goodwill emissary winning the loyalty of a harassed client, and there is a speculative element to risking the investment that is not without its thrill.

But how will the creditor know at what point to withdraw from the market in order to conserve his interest or minimize his loss? An indication is available in the case histories of Chicago bankrupts.

Where commercial ratings are available the problem is less intricate; but we have noted instances in which plausible but misleading statements from debtors have been made to credit agencies.

Including all types of business and all forms of organization, 79 percent of Chicago bankrupts had critical periods prior to application for bankruptcy of at least 6 months. About 59 percent were in obvious difficulty at least 12 months before action toward dissolution. Only a little more than 13 percent had been insolvent 3 months or less.

It would appear that in most cases sufficient time was available for adequate checking as to the credit risk involved. But this very fact is a commentary not alone upon credit negligence, but perhaps even

[11] John H. Cover: "Neighborhood Distribution and Consumption of Meat in Pittsburgh," University of Chicago, 1932.

more significant upon creditor leniency. The individual creditor is eager, of course, to retrieve as much as possible of his investment, and is keenly aware of the necessity of representing his interests in competition with other creditors. But he is also hopeful that his client may be experiencing only a temporary embarrassment, and that by withholding pressure the emergency may be successfully weathered.

There was no evidence of a relationship between the crucial period and the amount of assets remaining at the time of petitioning for bankruptcy. Assets were depleted either through liquidation in an effort to obtain liquid capital for continuing operation, or in the satisfaction of the pressed claims of creditors. Similarly, no relation was apparent between life span and the critical period.

CHAPTER XIII

PERSONAL AFFAIRS COMPLICATING MANAGEMENT DIFFICULTIES

The business machine frequently yields to human frailties. This is particularly true of small enterprises.

In the corporation, the struggle for power, ranging from a battle for proxies to despotic control within the management, frequently disrupts the economic development. In partnerships, friction may lead to collapse of the business with loss to the participating individuals. In the individual proprietorships, illness with attendant expenses, large numbers of dependents, extravagance, indolence, speculation, and similar problems have been important factors in failure.

INCIDENCE OF PERSONAL FACTORS

Estimates of the importance of domestic and personal factors in Boston [1] failures are recorded in table 129.

TABLE 129.—*Percentage of bankrupt concerns affected by adverse domestic and personal factors*

Business field	In the opinion of—	
	Bankrupt	Principal creditors
Manufacturers	27	12
Wholesalers	38	32
Retailers (merchandise)	39	30
Retailers (service)	36	32
Real-estate agents or dealers, builders, and contractors	30	27
Average	35	28

ILLNESS AND ITS COSTS

Three of the 30 St. Louis [2] drug store failures were attributed directly to illness, while in the cases of 41 of 487 New Jersey [3] bankruptcies, illness was a major element. Table 130 analyzes the cost of illness in 34 New Jersey cases.

TABLE 130.—*Cost of illness in 34 New Jersey cases*

Classification	Number	Total cost of medical care	Average per family	Range	
				High	Low
Contractors	3	$1,576	$525	$906	$275
Manufacturers	2	1,790	895	1,650	140
Real-estate dealers	1	700	700	700	700
Retailers	19	21,518	1,133	3,500	10
Wage earners and professional persons	8	4,717	590	1,400	50
Wholesalers	1	850	850	850	850
Total	34	31,151	916	3,500	10

[1] U. S. Department of Commerce, Domestic Commerce Series No. 69.
[2] U. S. Department of Commerce, Domestic Commerce Series, No. 59.
[3] U. S. Department of Commerce, Domestic Commerce Series, No. 54.

Almost 10 percent of the bankruptcies of individual proprietors in Chicago were attributable to personal and family affairs, with the burden of medical expenses accounting for 3.28 percent, and illness of bankrupt, 2.27 percent of all cases. In addition, medical costs were contributory factors in almost 4 percent of the cases in which other causes were considered paramount, with illness of the bankrupt a secondary factor in another 2 percent of the cases.

Something of the significance of medical costs in the experience of proprietors is observed in the following quotation:

> Ratios of medical and dental expenses to total income were computed for 326 families of individual proprietors. Seventy-three percent of the families spent less than one-fifth of their total income for medical and dental expenses. About 10 percent spent 50 percent or more of their income for medical purposes and 3 percent spent more than 90 percent of their income for this purpose. The average (mean) ratio of expenditures is 19.5 percent. The median ratio is 10.4 percent and the modal ratio 2.5 percent. The first quartile value is 4.5 percent and the third, 21.6 percent.

These ratios become even more startling when the small incomes of the 632 proprietors' families, for whom the information was obtainable, is recognized. Incomes as recorded are totals for the family, including the proprietor's withdrawals from business and the earnings of other members. One-fourth of the families had incomes between $1,000 and $1,599. Dividing the number of families into fourths, the lowest, or first quartile value, is $1,284, the second, or median, $2,004, and the third, $2,763. Almost one-half of the families had incomes less than $2,000, and 93 percent, less than $5,000. The average (mean) medical expense per family was about $438. One-half of all cases had expenditures of $200 or more in the year preceding bankruptcy, and 10 percent from $500 to $550.

In earlier considerations, reference was made to negligence and speculation as personal items affecting the enterprise.

It is important to recall that the incidence of these costs falls not alone upon the proprietor but upon the creditor as well.

Granting the importance of the vagaries of economic life and of environmental conditions in which the businessman is a pawn, it still appears probable that not less than one-half of business failures is directly chargeable to inadequate management. And most of the dissolutions resulting from this major factor are the inevitable result of the incompetence and inexperience of proprietors, discernible at the time of their assuming managerial responsibilities.

Motives activating their launching of new enterprises are in most instances commendable—the desire for independence and for an improved standard of living. Nor should subsequent efforts, after failure, be condemned. But such complete ignorance of the requirements and problems involved is demonstrated, that there is desperate need of a preconditioning through instruction and apprenticeship.

Control of capital, usually not the personal property of the manager, is a grave responsibility not to be entrusted to amateurs. Too frequently, a key to the door and a bland optimism are the chief assets of a new proprietor.

An experienced pilot is essential to guide an enterprise past the many shoals and through the recurrent storms of business life. He will make certain, first, that his boat is seaworthy, and then that he has adequate machines, fuel, crew, and ballast. Only then will he feel ready to enter competition for trade. The evidence of this sec-

tion of the report is almost incredible in its account of the many landlubbers who attempt to operate a merchant ship with rowboat oars.

If establishments commonly existed for the lifetime of the proprietor, their life span could be accepted as related to the active period of a generation. But this is untenable. In some fields 3 of each 10 newly organized business concerns fail to survive through the first 12 months, and 1 or 2 more of the 10 dissolve within 24 months.

The corporate form of organization, while setting up a legal person to outlive the human, fails to eliminate the personal factor. Frequently, its longevity advantage over the individual proprietorships or partnership appears to be largely in the intricacy of the corporation's ownership-management pattern. The corporation is so involved in its share-property rights that adhesions deter the effort toward dissection; and the time consumed by lawyers and the court is credited to longevity.

When a concern successfully weathers the early years, its chances of continuance in business are greatly enhanced. A partial immunity appears to be established.

Consequently, it is important to distinguish between mortality rates relating to new enterprises and those applied to all concerns in business. In instances, the former, "infant" mortality, accounts for one-half of the total turn-over.

The concerns well-nourished with capital investment appear, in general, to have a distinct advantage over the smaller enterprises. And small establishments do not tend to grow into larger ones; the weaker are eliminated.

While depressions and seasonal pressures affect mortality, more emphasis should be placed upon the long-time tendencies of turn-over. The mortality problem is always with us, whether we are of the horse-and-buggy, the streamlined-automobile, or the airplane age.

There appears to be no conclusive evidence that the small community is more favorable than the city to business survival. Evidence varies, in some instances supporting the advantage of the metropolis.

Human population changes may be a direct factor in determining the rate of mortality. This is particularly important as a basic consideration when proprietors gage their prospects in terms of business prosperity.

Business experiences are so dynamic and their relationships so diverse as to require comprehensive study of environments and antecedents as well as of current operations. Conditions vary by area, trade, and organization, in time and methods, and with technical requirements and consumer preferences. No local analysis can be considered a safe representation of the country as a whole. No composite picture discloses the individual features.

The whole of American life is involved, and the question before us is whether the material waste and the human displacement are necessary concomitants of free enterprise.

CHAPTER XIV

GOVERNMENT REGULATION AS A FACTOR IN BUSINESS MORTALITY [1]

It is a generally accepted premise that our social relations lag behind developments in our economic life. Currently we are conscious of the effort of our legislators to catch up with industrial developments. In fact, some commentators suggest that we have now entered the era of the quantity production of statutes.

It is not difficult to list important factors which form the basis of much of the current business legislation. We are experiencing rapid changes in channels of distribution, in business organization, and in business practices. We are finding the cost of marketing of products excessive. We are experiencing an alinement of business forces upon a national basis. We are aware of an expansion of monopoly devices. We are cognizant of the restrictions upon consumer purchasing power. We have observed increases in unemployment. We are aware of the use of legislation as a competitive or security power, and we have even come to realize that there is competition between State and Federal Governments for jurisdiction over trade and commerce.

Consequently, it is not surprising to observe opposing pressure groups struggling to enact legislation that will promote or restrict competition; that will alter or make rigid the existing channels of distribution; that will make price a barometer of the market, or that will stabilize it in the hope of assuring profits; that will permit certain trade practices as competitive advantages, or prohibit them as monopoly devices; that will use the taxing power for local trade advantages, or restrict assessments to the protection of the consumer and sound business, or exclusively for the raising of revenue.

Legislation for the advantage of pressure groups must necessarily prove discriminatory and lead to retaliation on behalf of other groups. We have reached the time for recognition of the need of careful analysis of these problems and of the effects of regulation. Our new legislation should be unified and coordinated, so that its application may be similar under all circumstances and the incidence of its effect may be foreseen wherever possible.

As laws require enforcement, their increase in number and application require additions to administrative agencies. When these laws are general in character, administrative procedures and interpretations frequently have the effect of statutory enactments. On the one hand this device provides latitude for the exigencies of each case; on the other, it frequently creates misunderstanding and opposition on the part of the unsuccessful appellant. Growth of administrative functions and of personnel is further promoted by the expansion of re-

[1] This chapter was written by Dr. John H. Cover. The survey in this chapter is strictly limited to that portion of governmental regulation directly affecting business mortality. It obviously makes no pretense of any kind at being a survey of all governmental regulation affecting small business. See in particular the bibliographical references in recent publications of the Marketing Laws Survey (in the Federal Work Projects Administration).

sponsibilities of a business nature undertaken by Government. Extension of control is frequently regarded by those affected as usurpation, particularly in a period of rapid economic and social change.

Regulations, such as the tariff, are often beneficial to some industries or kinds of business and prejudicial to others. In such instances they may act as insurance for one group and as an agent of liquidation for another. The history of our liquor-prohibition legislation is an example of industry's dependence upon social whims.

PURPOSES OF GOVERNMENT REGULATION

Some of our business laws were enacted to insure fulfillment of contracts between persons, or to prevent enforcement of agreements between unequal parties. Many are based upon the desire of our citizens to promote equal opportunity, to protect private and public welfare, and to provide the peaceful pursuit of our economic life.

The extent to which we tend to regulate our course and to restrict our individual initiative is illustrated in the following police order in a small town:[2]

SPECIAL NOTICE REGARDING WORKING ON MEMORIAL DAY, TUESDAY, MAY 30, 1939

This is a reminder of the fact that May 30, Memorial Day, is subject to Sabbath Day laws. This makes it necessary to secure a permit from local police in order to operate before 1 p. m.—and permits will be issued upon such terms and conditions as he deems reasonable, for such necessary work or labor which in his judgment could not be performed on any other day without serious suffering, loss, damage, or public inconvenience, if it can be proved that there is an emergency.

Statutes covering such restrictions are frequently enacted to conform to the religious tenets of the majority of the townspeople. But, in addition, they are supported by proprietors who wish to prevent competitors, otherwise not conformists, from taking advantage of an open store on holidays. In opposition, the proprietor denied the privilege may regard the regulation as prejudicial to his business interests and a "confiscation of property."

It is estimated [3] that only 25 of 120 basic activities of retail trade can be controlled by municipalities. For instance, the power to fix standards of weights and measures was granted Congress by article 1, section 8, of the Federal Constitution.

The original divisions of responsibility between the Federal and State Governments was largely in terms of foreign commerce and interstate commerce on the one hand, and intrastate trade on the other. But this cleavage is not clear-cut, as evidence will indicate.[4] In addition, our most recent attempt to solve the liquor problem has resulted in the allocation to the States, by constitutional amendment, of control which logically should remain within Federal jurisdiction.

TYPES OF REGULATION

It has been pointed out that while the theoretical purpose of regulation is the safeguarding of individual rights and of public welfare, there is frequently a discriminatory effect upon those to whom a

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[2] Industry, January 1939.

[3] Franklin W. Ryan: "Municipal Control of Retail Trade in the United States." Supplement to National Municipal Review, December 1935. vol. XXIV, No. 12.

[4] T. N. E. C. Hearings, Part 29.

prohibition applies. When laws of this kind are passed they impose a burden upon concerns that have operated to advantage under previous conditions, and may result in failure. This is true regardless of the social desirability of such statutes.

Control of entry into or expansion of business.

In addition to the requirements for corporate charters which differ widely as between States, most communities have license and franchise requirements for entry into certain fields of business, or dealing in particular commodities, or services.

The license requirements may stipulate the minimum capital necessary, the qualifications or number of persons employed, the location approved, or may include posting of bonds, or payment of special fees.

Franchises, granting certificates of convenience and necessity, originally applied to public utilities, more recently have been extended to businesses affected with public interest—milk, ice, coal, and trucking.

Zoning restrictions limit the location of business areas and the sites of particular industries. Most cities specify areas for manufacturing, wholesale and retail activities. In addition, many prohibit certain types, such as liquor stores, from using sites in the environs of schools, churches, or residential sections.

A common form of regulation is applied to commodities and services for which certain standards are required. We are acquainted with milk, meat, building material, and barber-shop inspection, with the registration of securities, and the censorship of theaters.

In instances, there is complete prohibition, such as the exclusion of narcotics, and of the use of white phosphorus in matches.

A recent new type of prohibition is illustrated in the following transient vendor ordinance, No. 175, of Green River, Wyo.:

> SECTION 1. The practice of going in and upon private residences in the town of Green River, Wyo., by solicitors, peddlers, hawkers, itinerant merchants, and transient vendors of merchandise, not having been requested or invited so to do by the owner or owners, occupant or occupants of said private residences, for the purpose of soliciting orders for the sale of goods, wares, and merchandise, and/or for the purpose of disposing of and/or peddling or hawking the same, is hereby declared to be a nuisance, punishable as such nuisance as a misdemeanor.

Monopoly and Practices in Restraint of Trade.

The proprietors of small business, if their various associations and trade journals represent their beliefs, have been convinced for the past three-quarters of a century that monopolistic practices are an important source of their competitive difficulties.

A summary of complaints made to the Federal Trade Commission and the Department of Justice with respect to the Sherman Act emphasizes: (1) Price controls, (2) control of distribution channels, (3) labor coercion in the nature of racketeering, and (4) miscellaneous practices, including control of location, development of special brands, and similar devices.[5] These practices, it is claimed, operate unfairly against the small, independent producer and merchant, making it difficult for him to survive.

In the experience of the National Recovery Administration,[6] the differences which most frequently gave use to conflict among business-

[5] Willard L. Thorp: Testimony before the Temporary National Economic Committee.
[6] N. R. A.: Report of the President's Committee of Industrial Analysis, February 17, 1937, pp. 204–205.

men and groups may be summarized as follows: Size, concentration upon market, costs, methods of operation, nature of the demand for products or services, service offered, development of prestige.

In the judgment of Prof. Frank A. Fetter,[7] important hindrances to the development of individual and independent enterprise are: (1) Political measures, such as tariffs and State licenses, (2) technical conditions requiring large and exclusive operations, and (3) changes in the law of industrial corporations, resulting in mergers, agreements, and new business practices.

Berle and Means [8] examined the largest corporations with respect to (1) gross assets and found that of 573 independent American corporations, 130 reported assets of over $100,000,000 and controlled more than 80 percent of the assets of all companies represented, (2) net income, and estimated that the largest 200 nonbanking corporations received considerably in excess of 45 percent of the net income of all corporations, (3) corporate wealth, and estimated that at least 78 percent of American business wealth is corporate wealth, (4) national wealth, and calculated the proportion controlled by the 200 largest corporations at a minimum of 22 percent in 1930. In all these categories the proportions appear to be increasing.

The foregoing analyses have been summarized to emphasize the imputed relationship between the large corporate organization and the special opportunity for business success. The small competitor claims that the advantage lies with size in almost every phase of business, quantity purchases, unit costs, integration, extension of market, expansion of products, extension of service, facility in financing, development of consumer goodwill, and establishing of prestige through advertising and special brands.

This attitude on the part of the small enterpriser and the general public has resulted in two types of legislation: (1) the penalizing statute, designed to prevent further combination, and (2) the enabling statute, to permit association of enterprises for promotion of common interests.

At first, both types of legislation were sponsored largely by the individual State. Antitrust laws had been passed in at least 13 States before 1890, but the Federal Government had to accept increased responsibility thereafter.[9] More recently, the second type of Government control has operated by fostering and stimulating the smaller business unit. The devices employed are examined in later sections of this report, where it will be interesting to note that the "small" businessman has set out to "combine."

Based upon the experience of the local businessman and the local consumer, States have frequently provided the laboratory for legislation subsequently adapted to Federal needs. The struggle of the local concern with the national corporation has in the past disclosed many practices which have been claimed as prejudicial to competition and to the local enterpriser. In order that we may be cognizant of the diverse nature of this problem and of its possible relation to mortality, it will be well to identify some of the restrictive provisions of many State constitutions and of the body of their laws. The general pur-

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[7] Frank A. Fetter: "Competition or Monopoly," Proceedings of the Academy of Political Science, vol XVIII, No. 1, May 1938, pp. 100–107.

[8] A. A. Berle, Jr., and Gardiner C. Means: The Modern Corporation and Private Property, 1934.

[9] Leverett S. Lyon, Myron W. Watkins, and Victor Abramson: "Government and Economic Life," vol. I, ch. X, The Brookings Institution, 1939.

poses usually are to prevent monopolistic practices and practices detrimental to the status of competitors; they regulate—

1. Capital combinations by consolidation, merger, trust agreement, interlocking directorate, intercorporate stockholding, contract, or other formal device;
2. Voluntary associations including pools, trade associations, trade agreements, codes, and gentlemen's agreements;
3. Concerted action leading to price fixing, price information, and agreement upon terms;
4. Agreements regarding production quotas, sales, and market allocations;
5. Patent pools, and cross-licensing for the sharing of patent rights;
6. "Blacklisting" practices in exchange of credit information;
7. Interference with a competitor's access to the market, by obstructing channels of distribution, or interfering with materials, equipment, or credit;
8. Agreements between seller and distributor to exclude another's products from their transactions;
9. Exclusive dealing, in which distributor agrees not to handle goods of a manufacturer's competitor;
10. Exclusive representation, an arrangement the reverse of item above;
11. Tying contracts compelling a purchaser of one item to purchase other goods as well;
12. Market boycotts in which there is concerted action to refrain from buying or selling;
13. Contracts not to compete, usually upon disposing of a business;
14. Predatory practices calculated to injure competitors;
15. Obstruction, intimidation, and molestation, including sabotage, espionage, blocking of credit or supplies, suits in bad faith;
16. "Bogus" competition, operations through concealed subsidiaries;
17. Brands and sales forces used for deceptive competition, usually called "fighting brands" and "flying squadrons";
18. Predatory price cutting to injure particular competitors;
19. Imitative goods, inferior in quality but resembling a competitor's products;
20. Disparagement of competitor's character, products, and business methods;
21. The misappropriation of a competitor's formulas, designs, trade secrets, and other intangible property;
22. Bribery of employees or customers of competitors;
23. Interference by a third party with a transaction between others.

Each of these practices has been effective in eliminating enterprises from business. The small proprietor is alertly aware of their discriminating nature. He associates them with "big business," with "corporations," and with the "interstate dealer." The inter vs. intrastate struggle is currently presenting one of our greatest national problems, for the local merchant has been seeking the aid of his community and State governments against the competition of the "foreign" competitor from the neighboring State. The movement toward local isolation can result only in the stagnation of exchange and the failure of many enterprises.

Interstate and Intrastate Commerce.

Under article 1, section 8, clause 3 of the Federal Constitution, "The Congress shall have power * * * to regulate commerce with foreign nations, and among the several States, and with the Indian tribes." In an early interpretation of the Supreme Court (*Gibbons* v. *Ogden* (9 Wheat. 1)), Chief Justice Marshall declared that the word "among" means "intermingled with" and was restricted to that commerce which concerned more States than one.

Therefore, it would appear clearly established that Federal jurisdiction covers interstate commerce, and State responsibility, intrastate. But unfortunately for our economic welfare and the solvency of business enterprise, the case is not so simple.

As an example of the complexity of the problem, the State of California applied a "use" tax, levied on storage and use of property, to property brought into the State by the Southern Pacific Co. as part of its transportation facilities. The railroad was refused an injunction and appealed to the Supreme Court. In a decision of January 30, 1939 (*Southern Pacific Co.* v. *Gallagher*), the Court concluded that there was a taxable moment when those articles had reached the end of their interstate transportation and had not begun to be consumed in interstate operation. At that moment, the tax on storage and use—retention and exercise of a right of ownership, respectively—was effective.[10]

The use tax is illustrative not alone of the difficulties involved in determining lines of demarcation between interstate and intrastate commerce, but, in addition, of recent State activities in support of resident business enterprisers.

Faced with the necessity of raising additional revenue, most States have enacted retail sales taxes. These taxes are levied at the time of the sale against goods purchased by the consumer. Depending upon a number of factors, they are paid by the consumer or by the merchant or producer. But it proved difficult to collect sales taxes upon products shipped to consumers across State lines; moreover, the question of jurisdiction over interstate trade was involved. The local merchant and producer felt that a discrimination against intrastate enterprises existed in the amount of the tax. They were at a disadvantage in competing upon a price basis. Consequently, many States enacted use tax laws which applied to the storage or use of products within the State.

So many of the regulations referred to as trade barriers have as an original purpose the increase in revenue or the protection of the citizens of the State or municipality, that it is difficult to estimate the extent of discrimination against nonresidents, the degree of local protective-tariff intent, or the restriction upon trade both interstate and intrastate. It seems probable that many of these regulations give temporary advantages to local business enterprises to the detriment of interstate competitors, and that the ultimate effect will be to decrease exchange and to curb business as a whole. The transitional step to failure of many enterprises is readily recognized.

To indicate the relationships involved, a few illustrations should suffice:

Protection of a State's domestic manufacturers and wholesalers of alcoholic beverages takes at least five forms: (1) Lower excise taxes on alcoholic beverages,

[10] National Tax Association Bulletin, vol. XXIV, No. 7, April 1939, pp. 218–219.

especially wines, which are manufactured from domestic rather than from out-of-State or partly out-of-State alcoholic beverages; (2) higher license fees on wholesalers who handle imported alcoholic beverages than on those who handle domestic products only; (3) special license fees or "certificates of approval;" for nonresident manufacturers who wish to ship into States; (4) requirements that a manufacturer qualify to do business in the State as a foreign corporation before he can secure a license; and (5) explicit or implicit advantages to domestic products given by the liquor stores in those States which themselves monopolize the retailing of liquor.

"Preference to farmer producers of raw materials usable in liquor manufacture may take several forms likewise: (1) Lower taxes on wines made from local raw materials than on those made from 'foreign' grapes; (2) sale by domestic producers directly to retailers rather than through wholesalers; and (3) requirements that a certain percentage of the alcoholic beverage be made from specified products grown in the State."[11]

Apparently as a means of financing the construction and repair of roads and in the interest of highway safety States have established registration requirements, levied taxes upon motor fuel, mileage, and gross receipts, and regulated truck dimensions and weight. Only 9 States grant complete reciprocity to commercial vehicles from other States.[12] To bear the accumulation of taxes imposed both by the home State and States of transit may be such a heavy burden upon any one vehicle as to exclude the enterpriser from interstate trade. In Ohio, caravaning vehicles are required to obtain "in transit" certificates of registration and two plates for each vehicle; $50 is charged for the original and $3 for duplicates. Arizona requires a wholesale peddler's license. For purposes of resale in counties of more than 100,000 population, the fee is $500; in other counties, $300; also a bond of $5,000 from surety licensed in the State. These regulations are not applicable to products grown by the vehicle owner. A merchant peddler using an automobile is assessed $200 per annum in every county and $25 for each assistant.[13]

Laws giving preference to their own products, contractors, laborers, or printing for institutions and Government agencies have been enacted by almost all States. Indiana requires limestone; Maryland, green marble; Missouri, products of her quarries; Oklahoma, local mineral and forest products.

Georgia designates as "fresh" those eggs produced in Georgia which are not decomposed, cold storaged, or processed; each egg brought into the State must bear the inscription "shipped". New Jersey eggs "contain more vitamins." In 1938–39 10 States spent $2,579,000 advertising one or more of the following "home" products to "foreign" State markets: citrus fruit, dairy products, apples, prunes, potatoes, onions, canned sweet corn, blueberries, lobsters, scallops, poultry, peaches, pears, wine, olives, and eggs.[14]

The tendency of these regulations is toward isolation. Progress in the United States has been aided by free trade among its people and specialization in production. A program of self-sufficiency in each State would be harmful to all. Michigan wishes to sell its automobiles to California and in exchange to purchase California citrus fruit and wine. Ohio has mining machinery for the coal mines of West Virginia and in return can use West Virginia coal. But in each of these instances regulations brought threats of reprisals which, if adopted, would have resulted in economic warfare.

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[11] Eugene F. Melder, "State Trade Walls," Public Affairs Committee, Inc., 1939, pp. 19–20.
[12] W. P. A. Marketing Laws Survey, 1939.
[13] Ibid.
[14] George R. Taylor, Edgar L. and Frederick V. Waugh, Barriers to Internal Trade in Farm Products, U. S. Department Agriculture, 1939.

Business enterprisers are aided by an increase in national income and in the standard of living of our people. Isolationist and protective tariff policies are agencies of business mortality.

Regulation of Marketing Devices and Practices.

Regulation of business practices has increased in importance as business organization and procedure have become more complex. We frequently think of competition in its price aspects and overlook the large number of nonprice elements involved.

Most Government jurisdictions have enacted statutes referring to a large diversity of items ranging from the identification, standardization, selling, transportation, storage, and warehousing of products, through financing and security, to marketing organization and exchanges. Considerable attention has been focused recently upon trade-marks and trade and brand names as identification devices; in the same category is deceptive and misleading advertising. Public interest has been directed to regulation of installment selling and to prevention of coercion in the selection of finance companies.

With a presentiment that business changes in process might result in a heavy toll for small, independent retailers and wholesalers, cooperative efforts have been directed, in the last 8 years, toward enactment of statutes with the following ostensible purposes:

1. Preservation of fair competition.
2. Preservation of existing channels of distribution, and of their agents: manufacturer, wholesaler, independent retailer.
3. Protection of the consumer and the general public.

These regulations have both price and nonprice aspects; the price restrictions will be discussed in the next session.

1. There is no agreement as to criteria to determine lines dividing "fair" from "unfair" competition, and the courts follow the procedure of deciding upon the circumstances of each case, considering "reasonableness" in restraint, "intent," and "incidental" discrimination.

A discrimination working hardship upon the small enterprise is charged in the ability of large distributors to purchase commodities at reduced prices. This opportunity is available because of the advantage to manufacturers of large orders. These orders may eliminate or at least reduce some of the selling expense of manufacturers, and brokerage fees are usually dispensed with through direct negotiations. Moreover, large distributors may aid in the financing of production. The large buyer certainly has bargaining advantages in comparison with the small distributor.

Indirect price reductions have been accomplished in the following manners: Advertising and other allowances; service, such as demonstrators, rendered by the seller to the buyer; special discount and credit policies; large trade-in allowances; allowances of brokerage to the buyer; secret rebates; special selling policy, such as cost-plus contracts. Some of these special terms are made illegal by the Robinson-Patman Act. As an instance, the following quotation refers to a court decision regarding the acceptance of allowances and discounts in lieu of brokerage: [15]

The United States Supreme Court on January 2, 1940, denied The Great Atlantic & Pacific Tea Co.'s petition for a writ of certiorari to review the judgment of the United States Circuit Court of Appeals for the Third Circuit affirming the Federal Trade Commission's order against The Great Atlantic & Pacific Tea Co.

[15] U. S. Department of Commerce, Domestic Commerce vol. 25, No. 1, January 1940, p. 4.

directing it to cease and desist from accepting allowances and discounts in lieu of brokerage in violation of section 2 (c) of the Robinson-Patman Act. The Commission's order prohibited The Great Atlantic & Pacific Tea Co. from purchasing commodities at so-called net prices which involved a price concession in lieu of brokerage, from accepting so-called quantity discounts, and other types of discounts granted in lieu of brokerage, and from accepting discounts and payments of all kinds representing, in whole or in part, brokerage on its own purchases.

In affirming the Commission's interpretation of the law, the lower court held that the services-rendered clause of section 2 (c) of the act, the brokerage paragraph, did not set up a condition upon which brokerage could be paid or allowed to a buyer on his own purchases, but that the paragraph absolutely prohibited the payment of such brokerage. The circuit court also held that paragraph (c) was entirely independent of paragraph (a), the general price discrimination paragraph of the act, and the provisions of the latter could not be read into the former. The court said that paragraph (c) as construed and applied by the Commission was not violative of the Constitution.

This is the second case in which the Supreme Court has refused to review a Circuit Court of Appeals decision affirming a Commission order entered under section 2 (c) of the Robinson-Patman Act, the other having been in the Biddle Purchasing Co. case in which certiorari to the Second Circuit was denied on October 17, 1938.

Group-buying organizations, largely through controlled central offices, enjoy privileges similar to the large distributor.

In addition, special merchandise, such as private brands, or special grades, qualities and sizes, is available to the large-order buyer.

2. The traditional channel of distribution connects the manufacturer with the independent wholesaler, occasionally with a broker intervening, and the wholesaler with the independent retailer. It is natural, therefore, that the independent wholesaler and retailer regard integrated business as an agent of destruction.

Legislative aid is sought against the chain store, mail-order house, department store, price-cutting independent retailers, supermarkets, vertically integrated distributors and group-buying organizations. Perhaps in the future we shall find this antagonism extending to consumers' cooperatives, farmers' cooperatives, retailer cooperatives, and voluntary wholesaler-retailer groups.

The manufacturer frequently is caught between the desire to assure large-scale production through the stable orders of the large distributor and the eagerness to continue wide-spread distribution to all classes of consumers through the independent merchant.

3. The independent claims that policies followed by his large competitor are likely to result in the elimination of the small enterpriser and monopolistic domination by the national concern to the detriment of the consumer.

Certain essential types of services and qualities of goods may be dispensed with, it is argued, in the process of price competition.

Laws are urged to protect the general public against certain dangers inherent in mass distribution, particularly in chain-store operation. It is contended that, except in metropolitan centers, absentee management has resulted in the underpaying of employees, the concentration of economic power, the draining of funds from the community, and an indifference toward local problems, charities, and community activities.

The national distributor has denied the charges. Chain enterprises particularly have offered evidence in contradiction.

Regulation of Price Policies and Practices.

Of prime importance in the activities of independent enterprises, particularly of retailers and wholesalers, in bringing governmental services to their aid, are the resale price maintenance laws, so-called "fair trade" regulations; the regulations concerning sales below cost, the "unfair practices" acts; statutes controlling price discrimination between localities and between buyers; and indirect devices, chain-store taxes and special licensing laws.

In terms of the three contentions used in the immediately preceding section, "Regulation of marketing devices and practices," the problems as they may affect mortality are outlined as follows:

1. *Preservation of fair competition.*—Elimination of price cutting and discrimination between buyers are the two leading objectives of price regulation.

A general low price policy is made possible, the antichain group contends, by special buying techniques, limited service, cheap fixtures, low rentals, and limited lines of merchandise.

An aggressive price cutting on selected items, called "leaders," is aided by choosing certain nationally advertised products, or standard products, such as sugar or salt, or products upon which price comparisons are difficult. The amount of mark-up is important, also, since sales on a limited number of articles have been made below invoice cost; or the mark-ups have been so moderate as to fail on a basis of cost allocation to cover selling expense. Claims through advertising of a general underselling policy have been patently unfair in many instances, or, if true, have earned the hostility of competitors.

Locality price discrimination has resulted from two general factors. In one instance, certain outlets of the supermarket, or limited service, type have been low-operating cost units and have been able to afford low prices. In contrast, some units have charged low prices as a means of developing a competitive advantage, the other units in the system carrying the burden.

Discrimination between buyers, as recorded in the previous section, may result from the economy of dealing with large enterprise, or from the bargaining power of large buyers. It is difficult to establish the point at which concessions are unwarranted or excessive. The devices used are special prices, quantity discount, or volume discount; in addition special selling policies have been employed, such as cost-plus contracts. The elimination or diversion of brokerage is essentially an indirect price reduction.

2. *Preservation of existing channels.*—The relation to price of short-cut channels is largely in terms of the elimination of separate steps and the saving of costs. There are theoretically fewer mark-ups and a conservation of sales and buying effort.

The chain store, mail-order house, department store, and similarly integrated organizations are viewed by the independent wholesaler, retailer, and broker and commission merchant as marketing developments potentially detrimental to their existence. Aid of Government is sought in an effort to equalize competitive opportunity, or, as charged by critics, to eliminate competition.

The manufacturer is concerned in this struggle because he is the source of supply on the one hand, or the displaced producer on the other. To refuse supplies to large purchasers might lose to the manufacturer not alone a large volume of sales, but, in addition, a basis

for stabilized production. Moreover, the large enterprise might decide to manufacture a competitive product. Sales to the many small concerns are expensive.

The large distributor is in position to insist upon special terms including drastically cut prices.

Of concern, also, is the effect of "leader" sales. If the manufacturer's product is used as a special inducement to customers by some merchants, others may be reluctant to carry this item. Continued sale of a brand at low prices may cheapen it in the consumer's mind and lower its prestige. A habit may be established with resultant resistance when the price is reestablished.

3. *Protection of the consumer and the general public.*—The proponents of price regulation contend that the consumer and public are misled by the tactics described.

Leader, or "bait" advertising, it is held, induces the customer to enter the store where an effort is made to sell other or substitute items at inordinately high prices.

The low prices on some items, in the opinion of opponents of the practice, require high charges in general to compensate; or an inferior quality or service is made necessary.

Ultimate elimination of the small enterpriser would result, his representatives insist, upon a considerably higher level of prices to the consumer, and a lowering of living standard for the general public.

Most of the States have enacted "fair trade laws" enabling the manufacturer to establish the price of resale in a contract with one or more retailers; when the contract is in effect it is equally binding upon all other merchants. A Federal statute, the Miller-Tydings rider to a District of Columbia appropriation bill, is an enabling act facilitating administration of these laws. Retail drug organizations have been particularly active in supporting these measures.[16]

Many States have passed "unfair trade practices laws" regulating sales below cost. The difficulty of defining "cost" has made these statutes less enforcible than the resale-price acts. The grocery field has been much interested in this type of legislation.

Price discrimination has received the attention of most States and of the Federal Government. The Robinson-Patman amendment to the Clayton Act has been upheld in the courts.

Chain-store taxes and special licensing laws have been variously enacted. The most frequent tax levy is upon the store itself, in some jurisdictions, such as Louisiana, applying to the number of outlets in the entire country. Tennessee has enacted a levy upon floor area. In certain current bills it is openly proposed to forbid the operation of the chain-store system.

Unfortunately, there exist no factual data adequate to a determination of a sound policy and legislative program.

The problem is complex, and although there is general agreement that discriminating practices should be outlawed, there is available currently no basis upon which to determine the line of demarcation between efficient, large-scale operation and unfair competition.

The small, independent merchant has observed the tactics of large enterprise and of other groups in pressing their special interests and desires upon State and national legislatures. In the last decade the growth of pressure organization among some retail trade groups has

[16] E. T. Grether: Price Control Under Fair Trade Legislation, Oxford Press, 1939.

resulted in a stampede of legislatures. Since 1931 most of the States have enacted resale-price-maintenance laws, passing bills so rapidly as to adopt statutes from other States including even typographical errors.

This wave of protective legislation leaves no opportunity for study of merits.

Since no adequate, objective study has been made of these problems, no conclusion can be reached as to the effect upon public welfare or upon the business enterprises of these many laws. Only cautionary observations can be made. It is difficult to see how maintained and cost-fixed price, if widely applied, can avoid a higher price level and a reduction of demand; these are the elements of reduced patronage and insolvency. It is difficult to see an advantage to the public in trade restraint by one group as against another.

Still more reprehensible is the use of government for private advantage.

GOVERNMENT AID TO BUSINESS

While there is general familiarity with the extent of Government activity in the regulation of business, less recognition is given the wide range of benefits derived from other functions. Daily research [17] covers fields as widely divergent as the development of sturdy grain and the stabilization of trade. Information flowing from Government sources gives the American businessman an advantage in the conduct and planning of his enterprise unequaled elsewhere in the world.

But among the problems barely touched by Government or private analysis is the relation of Government aid to business success.

Gilt-edge invitations.

It would be enlightening to list the direct forms of assistance sponsored by Government—soil and water conservation, public highways, health and police protection; these types are of general benefit to the business community. Others would appear, on the surface, to advance the interests of limited groups. In this category are tariffs, subventions, and bounties. To determine the special as against the general welfare involved requires much more information than is currently available.

For immediate purposes, certain special aids and inducements should be mentioned as bearing upon the problem of mortality.

In turning the phrase that the South is the country's economic problem No. 1, the following advertisement appeared in many periodicals over the names of the Governors of North Carolina, Louisiana, Georgia, Mississippi, Florida, Tennessee, Arkansas, South Carolina, and Alabama:

ECONOMIC OPPORTUNITY NO. 1

We, the Governors—invite industry to the Southeastern States.

Industry seeking lower production costs and better profit possibilities will find the Southeast economic opportunity No. 1. A moderate year 'round climate makes possible lower living costs for better standards of living, ideal working conditions, lower capital investment, and lower production costs. Add to these powerful attractions: Unlimited supply of raw materials, ample powers, excellent transportation facilities to rich and growing markets, and you will understand why industry in ever-increasing volume is moving into the Southeastern States—why the Southeast today is economic opportunity No. 1.

SOUTHEASTERN GOVERNORS' CONFERENCE.

[17] National Resources Committee, Research—a National Resource. 1. Relation of the Federal Government to Research, Washington, December 1938.

In addition to advertising, the States have made direct bids to lure industry. Chief inducements are tax exemptions for periods of from 5 to 15 years, and the provision of land, plants, and equipment for new industrial firms.

Property tax exemption on all industrial construction for a period of 10 years was approved by Louisiana voters in adopting two amendments to the State constitution in 1936. One authorizes municipalities and parishes to exempt new industries or additions to established plants; the other empowers the Governor to contract with new or developing industries for exemptions.[18] In the period to February 1938, 53 exemptions had been granted, including oil, kraft pulp and paper, public utility, lumber, food manufacturing, chemical and cotton industries. It was claimed that 86 new plants had been established.[19]

That there are many liability as well as asset items to be considered by industry in studying inducements to migrate is illustrated by the situation reported for the State of New Jersey as of late winter, 1938.[20]

New Jersey has in the past 2 years attracted 3,440 new plants, employing 52,000 wage earners, according to the State Department of Labor. Low corporation taxes have been a factor in the migration of industry to the State. The State does not levy a franchise tax on industry 50 percent of the assets of which are invested in manufacturing, farming, horticulture, or mining. The corporation tax rate is low enough to attract some industries from across the river where the franchise tax is considerably higher. New Jersey has no income tax. There is no sales tax.

The State has an intangible property tax. There is also a tax on tangible personal property, the statute requiring assessment of true value.

New Jersey ranks among the first 10 States in population although it is among the 5 smallest in area. The western section is within the radius of such important industrial centers as New York and Philadelphia. In comparison with other States, New Jersey has a relatively high per capita debt both for the State and its localities.

Local property taxes are levied at a higher rate than in many of its neighboring States. High real-estate taxes are attributed by observers mostly to the inefficient collection laws, and partly to the fact that real estate provided most of the tax moneys.

State debt amounts to about $172,000,000 as against a sinking fund of $88,000,000. Because of the high debt in many of the cities, there is a relatively high tax rate in those cities as compared with other cities of the same population.

Industry moving to New Jersey would probably weigh as advantageous the relatively low rate of levy on corporations, the distribution advantages of manufacture, and the labor situation which has been relatively free from discord. On the other hand a sharp eye would have to be kept open for real-estate tax rates.

An interesting commentary on competition through exemption which took the form in Pennsylvania of a survey sponsored by the State Chamber of Commerce, and which condemned tax increases, is quoted from the report.[21]

That industries are leaving Pennsylvania is indisputable. To what extent such migrations are due to regional shifts or to natural spreading out of industry, and

[18] Business Week: "Vie in Tax Exemption," Mar. 27, 1937.
[19] Business Week: "Diversification Goes South," Feb. 12.
[20] Barron's: "New Jersey Bids for Industry," Mar. 14, 1938.
[21] Leonard P. Fox: State Taxes and Industrial Growth, Pennsylvania State Chamber of Commerce.

would occur regardless of our State tax situation, is a controversial question which we shall not attempt to discuss here.

Early in May of this year we learned that a State chamber of commerce in a border State had received 113 requests from industries that desired to move there from other States. Of these requests, fully one-half came from Pennsylvania. This is a serious state of affairs, even if some of the industries were undesirable in character and their migration would be a good riddance to Pennsylvania.

Many communities have rued invitations to citizenship after the industrial guests have arrived.

Although it is not the purpose at this point to discuss migration, it is important to report conclusions of some investigations. One statistical study [22] concludes that the geographical shift of industry between 1899 and 1933 was of less importance than the migration from large to small communities.

The question of the relation of taxation to migration has been considered statistically in a study [23] of the relative tax burdens, geographical contiguity and industrialization of various States. It was concluded that "heavy taxation has apparently placed little inhibition upon rapid industrial development in prosperous years. Relatively light tax burdens * * * have not proved a stimulus to the development of industry in years of prosperity."

Most States have tax exemptions, though not usually for the enticement of new industry, but rather to avoid double taxation. States seek to avoid both a property tax on land and upon the crop from the land; and they try not to jeopardize subsistence needs of the means to obtain it.[24]

An example of direct physical assistance is illustrated in the activity of Mississippi.[25]

Tax exemption on property to lure business was authorized in the Mississippi State Constitution in 1890. But the granting of tax exemptions was considered inadequate for a satisfactory industrial development of the State, and municipalities sought to offer more attractive inducements to industries. The town of Booneville was the first to offer industry substantial aid by voting a bond issue to build a factory to be leased to private enterprise. The State supreme court ruled that the act violated the State Constitution in that it provided funds in aid of a private corporation (*Carothers* v. *Town of Booneville*, 169 Miss. 511).

In 1936 the legislature authorized municipalities to own and operate manufacturing plants or to sell or lease them for operation by private concerns. This legislation followed a report which claimed that "an acute economic emergency" existed in the State of Mississippi, and that "present public policy demands a program to encourage and promote agriculture and industry with industrial expansion for the promotion of the general public welfare." A test case was ruled upon favorably by the State supreme court when it upheld the bond issue of the city of Winona for the construction of a municipal factory building to be leased to a private concern (*Albritton* v. *City of Winona*, 178 So. Miss. 799). The court held that municipal ownership of pri-

[22] Daniel B. Creamer: "Is Industry Decentralizing?" University of Pennsylvania Press, 1935.

[23] George A. Steiner: The Tax System and Industrial Development, Business Research Bulletin No. 57, University of Illinois, 1938.

[24] Jens P. Jensen: Tax Exemption as a Means of Encouragement to Industry, University of Kansas, Kansas Studies in Business, No. 10, May 1929.

[25] M. H. Satterfield: Mississippi Municipalities and Industrial Promotion, Bulletin of the National Tax Association, December 1938.

vate enterprises was a reasonable method to accomplish governmental functions—care of the poor, relief of unemployed, and the promotion of agriculture and industry.

The procedure in inaugurating industrial promotion is as follows:

1. A municipality, upon petition of 20 percent or more of the qualified electors, may make application to the industrial commission for a certificate of convenience and necessity to engage in industrial enterprise.
2. The commission determines whether the applicant has sufficient means to conduct such an enterprise without undue burden upon the community.
3. Should the application be approved, the commission determines the type of enterprise, the amount of land acquired and the amount of land that may be expended; the number of bonds issued, their maturity dates and the amount of taxes that must be levied to retire the bonds.
4. Before an industrial plan approved by the commission can be put into effect, it must be approved by the qualified electors of the municipality.

In efforts to solve problems of unemployment distress and business depression, many governmental jurisdictions have enacted legislation to stimulate local industrial development. In most instances measures used have been competitive with other jurisdictions, the effort to gain by another's loss. This procedure is inimical to the economic and social unity of the United States.

There is a natural economic progression with population flux, business expansion, industrial displacement and technical change. When new industries appear and older plants expand or migrate under these circumstances the public is benefitted. But when artificial, competitive stimulus is given to movement or expansion there is grave danger of ultimate disorganization, dissolution, and waste.

SUMMARY

Rapid changes in our economic and social life have influenced governments to attempt by legislation and administrative action solution of problems which are regarded as factors in our instability. At the same time, business interests have sought the aid of government in an effort to protect them from certain practices of competitors, or to support them in competing with others.

As a result there has developed a conglomerate of statutory provisions enacted by Federal, State, and local governmental agencies, supported by pressure groups. There is no objective attempt at coordination. There have been no adequate analyses of the impacts of regulations, or of their effects upon the business community or the public.

In many instances the competition has spread to antagonism between and retaliation upon governmental jurisdictions. In the milieu are the seeds of economic chaos and of business mortality.

PART II

MARKET SECURITY AND PRICE STABILITY

(SOME PHASES OF COMPETITION IN DISTRIBUTION)

FOREWORD TO PART II

Fifty years ago, when a national antitrust policy was enunciated in the Sherman Act, the problems of size and monopoly, then as now often incorrectly identified, were found chiefly in mining, manufacturing, and transportation. Activities "in restraint of trade" usually took the form of selling practices of manufacturers, or of methods designed to keep competitors out of a field by such means as patents, exclusive dealing contracts, boycotts, and other restrictive controls. No attention was paid to the fact that the most effective monopoly of the time was the small retailer—the general store at the crossroads—whose customers were as dependent on this single source of supply as the desert inhabitant on his oasis. Even the small town provided similar local monopolies in many of the specialized fields where the market could support only a single store.

The weakening of these local monopolies, thanks to the railroad, the mail-order house, and the automobile, paradoxically brought retail distribution within the scope of the student of concentration and competitive practices. The same forces which extended trading areas created mass distributors, with buying power sufficient to make their market position subject to critical scrutiny. And with the growth of chain stores and supermarkets, the problem of large versus small is nowhere as burning as in retail trade.

The current report presents data concerning recent trends in the field of distribution. It is clear that major changes have been and are taking place. While costs of manufacture have been declining, costs of distribution have been increasing. We have changed from an economy unable to produce all the goods demanded by consumers, to one where the vital problem of the businessman is to market the goods which he is able to produce.

This report is limited chiefly to those trends for which statistical evidence is available. Part of the conclusion must be that at many points, the statistical data are inconclusive. And back of these objective measures lie the human struggle for existence, the search for effective methods of competition, the cry for legislative aid, and the impact of changing techniques and products on the problem of selling. If they show nothing else, the statistics show that distribution today is a complicated process, with no simple standardized pattern, but with many methods and processes side by side, fighting for their existence. Part of the determination of survival will depend upon the concepts of "unfair competition" current in business practice and defined in the law. Here economic, social, and political values all converge, and the future is still to be determined.

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CHAPTER XV

THE STRUGGLE FOR MARKETING CONTROL[1]

CHANGING CHANNELS

Traditional Methods.

Marketing channels are the methods used in moving merchandise from producers to consumers. There is historical evidence that these channels were at one time quite simple. Indeed during the handicraft stage of production, direct sale from producer to consumer dominated the marketing of manufactures, many, if not most articles being made to order. The formal distribution system of those earlier times was limited very largely to market days, to periodical fairs, to which producers and consumers alike flocked, and to itinerant merchants. There was in addition some international trade, largely confined to luxury goods and to essential materials such as salt, iron, and spices.

In the United States, the traditional channels of distribution for manufactured goods, with which this study is chiefly concerned, have been manufacturer to wholesaler to retailer, with some use of agents, brokers, and factors of various types evident from the first. Indeed this traditional system of distribution was characteristic of American marketing until well into the present century.

The New Era.

A change in distribution techniques became inevitable with the maturing industrial era. Efficiencies of mass production are conditioned upon volume output, which in its turn must have volume consumption. A prime essential, the absence of which was a limiting factor upon the full flowering of the industrial revolution, was therefore a marketing system which could absorb the accelerated distribution functions essential to large-scale output. The profit possibilities of mass manufacture insured that a way would be found to dispose of the output. Pressure was thus automatically generated for modernization of marketing channels. It is perhaps no great exaggeration to say that the struggle for economic power picked out the wholesale marketing system for a battlefield, and there the war still rages.

Marketing Functions.

Essentially the struggle is for control over the marketing machinery—over who shall perform the marketing functions. It should not be overlooked, in evaluating this problem, that there are a large variety of inescapable marketing functions which must be performed by someone. These functions of marketing include assembling, buying, or purchasing; advertising and selling; grading, sorting, and standardization; transportation and delivery, storage, and warehousing; financing sales; keeping records, extending credit, and, above all, assuming the risks of marketing. There are many other functions

[1] Written by Dr. Nathanael H. Engle, Assistant Director, Bureau of Foreign and Domestic Commerce.

or tasks which the marketing of goods entails and which consumers demand. Some marketing agency or person must assume the responsibility for seeing that these marketing jobs are done promptly and efficiently. Channels of distribution are but agencies or institutions which perform the functions of marketing in varying degrees, some more, some less. The shifting of these functions underlies the changing pattern of marketing channels.

Present Pattern of Marketing.

The extent of the losses or victories of competing channels are difficult to evaluate precisely since comprehensive statistical data were not available until the 1929 Census of Distribution was taken. Since then additional facts have been assembled which permit a closer quantitative scrutiny of the magnitude of the struggle in this field. The Census Bureau reports seven different types of distribution channels utilized by manufacturers to sell their goods. In 1929, reporting manufacturers indicated that 7.4 percent of their sales were negotiated by agents or brokers of various sorts. By 1935 the ratio had increased to 8.3 percent. Sales to wholesalers dropped from 31.8 percent of the total to 27.3 percent between 1929 and 1935. Similarly direct sales to industrial consumers fell from 26 to 24.6 percent during the same period. Manufacturers reported larger sales through wholesale branches which they themselves owned and operated, the ratios rising from 18 percent in 1929 to 20.6 percent in 1935. Direct sales to retailers also expanded from 20 to 22.9 percent between the two dates. Some manufacturers operated their own retail stores but the total was small, comprising but 2.4 percent of sales reported by manufacturers in 1929 and 2.2 percent in 1935. Despite our consciousness of house-to-house salemen of brushes, silk hosiery, and vacuum sweepers, only 1.8 percent of manufacturers sales were reported as direct to household consumers in 1929. While there was a relatively large increase by 1935, the total was only 2.4 percent in that year.

These general summary data from the census require some modification for the purpose of this discussion. As has been pointed out by students of the subject certain limitations inhere in the crude census statistics. A refinement of the figures reveals that wholesalers lost ground in the percentage of business which they enjoyed from 90 comparable industries between 1929 and 1935 to the extent of from 3.1 to 4.1 points depending upon whether a weighted or unweighted average is used. The crude census figure shows a loss of 4.5 points.[2]

There were, however, variations from one industry to another, and in 21 of the 90 industries surveyed by Dr. Thorp, wholesalers actually gained some ground. A careful examination of each industry would bring out the exact areas within the marketing arena wherein wholesalers have gained ground and those in which direct selling is advancing. There seems to be no clearly defined pattern.

The significance of these data perhaps lies more in comparison with prestatistical days than in the relatively small changes revealed for the two recent bench-mark years, that were indeed characterized by depression conditions which make conclusions as to trends uncertain at best. If it be assumed, as seems reasonable in the light of historical evidence, that there was a time 30, 40, or 50 years ago, when the

[2] See Willard L. Thorp: Changing Distribution Channels, the American Economic Review Supplement, vol. XXIX, No. 1, pt. 2, March 1939, pp. 75-84.

traditional channels of distribution prevailed, wholesalers must have handled a much larger share of the total business than they do today. In fact there is little doubt that they handled nearly all of the business in early days. If this be a reasonable assumption, the decline of 3 or 4 points in the share of the total business which wholesalers lost between 1929 and 1935 may be interpreted as a continuation of a long-range downward trend and the importance of the statistics lies in the fact that they show wholesalers having but 30 or 40 percent of the current volume of trade. Similarly the increasing proportion of direct selling both to retailers and through manufacturer-owned wholesale branches must be looked upon as the prolongation of trends which had their roots in the titanic struggle for control of the marketing mechanism.

Contestants in the Struggle for Control.

Wholesalers, manufacturers, and retailers are the major groups of contestants for control of the marketing mechanism.

Wholesalers.

Wholesalers are much misunderstood middlemen. The N. R. A. experience brought out the fact that there was a wide difference of opinion even within the trades about what constituted a wholesaler. The confusion arises from the fact that the field of wholesaling, as covered by the census, includes all agencies which operate in the wholesale field, which perform wholesale marketing functions. These agencies include agents, brokers, manufacturers who operate their own wholesale branches, chain-store systems which maintain their own wholesale warehouses, and independent wholesalers. The word wholesaler should properly be limited to the independent merchant who owns and operates a warehouse, buys most of his stock of merchandise outright and performs the important storage function, maintains a staff of salesmen, and sells largely to the retail trade or to industrial or institutional buyers. In general the wholesaler performs all of the marketing functions, whereas other types of middlemen operating in the wholesale market perform only a part of the functions or limit their operations to the goods of a particular producer.[3]

Wholesalers had enjoyed a rather large measure of control over marketing in the United States from the earliest times. Direct descendant of colonial importers, they grew up with the country and waxed wealthy and powerful in their growth. It was the wholesalers who were the big businessmen of the early nineteenth century. John Jacob Astor, for example, a leading wholesaler of his day, is said to have been the only millionaire in the United States during the first decade of the last century. These wholesalers were able to dominate the puny manufacturing industries of the early industrial revolution. They provided about the only means of disposing of the manufacturers' output. They had access to greater stores of capital and often were able to finance nascent manufacturers. Retailers were largely of the general store type and had to depend on wholesalers for such manufactured goods as they handled. Wholesalers kept pace with the changing patterns of trade from rural to urban markets, and from general line to specialty merchandising as long as such changes were slow. Thus, with the growth of cities, retail shops developed which were able

[3] See Beckman and Engle: "Wholesaling, Principles and Practice," ch. 2, The Nature of Wholesaling, Ronald Press, 1937.

to specialize in groceries, in drugs, in dry goods, in hardware, in shoes, and in clothing. Wholesalers followed or, perhaps more accurately, kept pace with these changes, and retained their dominant role in the marketing structure until well into the twentieth century. Throughout this period the secular trend of consumer demand was upward. True there were cycles of depression and wars, which had their serious reaction upon business, but the rapid growth of population and the conquest of a rich continent maintained a pressure of demand that justifies the characterization of the era as a sellers' market. By this is meant that more and more goods of an ever-widening variety were absorbed about as fast as they could be produced. Manufacturers found little trouble in disposing of their capacity output. Wholesalers were eager for more goods to meet the growing demands of retailers, and retailers found profitable employment in supplying the expanding demands of a population which was making rapid strides in raising its standard of living.

Manufacturers.

The ripening of the industrial revolution to a stage where mass production with its potentially great economies became widespread precipitated a change in the dominant status of the wholesaler. The manufacturer became more important with his increase in size. He gained access to larger volumes of capital through the development of corporate financing. He was rapidly assuming proportions which freed him from dependence upon the wholesaler. The latter, moreover found difficulties in adjusting his operations rapidly enough to the vastly accelerated tempo of the new order. Where he had once eagerly sought out new products to handle, he was now faced with an amazing array of products many of which were essentially identical in their use but which manufacturers attempted to differentiate in order to secure competitive advantages. Thus friction developed between manufacturer and wholesaler, as the latter resisted the pressure to add new items when he was stocked adequately with the same goods under other names or in other packing. Constantly goaded by the hope of increased gain through larger volume with its concomitant lower costs, the manufacturer turned from the wholesaler to other channels or sought means of compelling cooperation from wholesalers.

Retailers.

Retailers, not the old-fashioned country general store type of retailer, but newer types which were developing as a response to the needs of the times, offered one alternative to the manufacturers in this crisis. Dissatisfied with the wholesale price structure, or feeling that lower prices to consumers would bring increased volume and profits, and failing to secure what they considered adequate concessions from the wholesalers, a new crop of retailers appeared on the scene. Direct buying and low prices to consumers with reduced services characterized these new retailing types. First came the department store, followed quickly by the mail-order houses and the chains. More recently supermarkets have made their appearance.

These newer types of retailing provided the answer to the prayers of mass producers for a system of mass distribution. But they did not stop there. Their rapid rise soon placed them in a position to compete powerfully for control of the market, not only with wholesalers which they displaced, but also with manufacturers. They were

soon bringing pressure to bear on the mass producers to split their profits with them. They argued that low costs were possible only by volume production and volume production was made possible by their large-scale orders.

NATURE OF THE STRUGGLE

Competitive Devices.

Manufacturers had not been idle meanwhile but had sought out other methods of competition. They did not relish too great control of their markets either by wholesalers or by the newer types of retailers. They found convenient offensive weapons in product differentiation, packaging, labeling, branding, and in advertising. National advertising in particular became a powerful tool in the hands of manufacturers for exercising control over the distribution of products. By the widespread and continuous use of advertising, manufacturers were able to build up in the consumer's mind recognition, acceptance, and even insistence upon his particular product. Retailers, large-scale and small, integrated and independent, were then placed under pressure to stock the nationally advertised items. Wholesalers also felt the same pressure as the demand was transmitted to them from the retailers. Thus the manufacturer was placed in an advantageous position to control his market. Some manufacturers pushed this advantage too far by attempting to compel acceptance of an entire line in order to secure certain advertised items for which consumer insistence had been developed. Manufacturers also attempted to reduce margins on the grounds that advertised goods require less selling effort by wholesalers and retailers.

Counter-offensives were initiated by both wholesalers and large-scale retailers. Both adopted private brands and found manufacturers who were willing to make them. Indeed some of the products so supplied were manufactured by the national advertisers themselves, glad to secure increased volume by this method. The product supplied under private brands has frequently been identical in quality with that put out by the manufacturer under his nationally known brand. To complicate the problem still further some of the private brands have also been advertised nationally by the chains, mail-order houses, and department stores which have developed them.

Wholesalers have brought still another weapon into the struggle for control of the channels of distribution. Raked by the cross-fires of direct-selling manufacturers on one flank, and direct-buying retailers on the other, wholesalers, in the grocery field particularly, but also in several other lines, have turned to closer cooperation with their independent retail customers. So-called voluntary chains have been established which have strengthened the competitive position of the independent retailers and indirectly bolstered up the wholesalers.

Legislative Action.

Despite these efforts the depression of the 1930's caught the independent wholesalers and retailers in a weak position. Feeling that the struggle was too great for them, they shifted their ground from the economic to the political field and started a legislative offensive against their competitors. The chain stores were attacked first by the method of taxation. A number of States passed chain-store tax laws designed to reduce somewhat the competitive advantage of the chains. Such legislation had made little headway by the time of the

great depression. The change in the national administration in 1933 opened the door for more aggressive utilization of legislation. The N. R. A. with its codes of fair competition was seized upon as a mechanism for strengthening the position of the wholesaler. The vistas thus opened sharpened the appetites of the hungry independent wholesaler and retailer for more legislative protection, when the N. R. A. was eliminated by the Supreme Court decision in 1935. Both national and State legislation followed. The Robinson-Patman Act, the Miller-Tydings Act, and the multitude of State fair-trade and unfair-practice laws were passed. Chain-store tax legislation also enjoyed a recrudescence.

The struggle on the legislative front followed three different patterns. First the legislation was leveled directly at the competing institution through tax laws so designed as to reduce profits in the hope that the competitor would either have to increase prices or go out of business. The two other types of legislation were aimed at eliminating alleged unfair advantages or abuses said to be practiced by the mass distributors. The attempt to eliminate the alleged buying advantages of the large-scale retail organizations was embodied in the Robinson-Patman Act. So-called unfair-practice acts attempted to freeze the distributive margins of all types of distributors in order to protect the margins of the independents, an objective which was paralleled by resale price-maintenance legislation passed under the guise of fair-trade laws.

None of these laws appears to have been as effective in achieving the objectives of their sponsors as was originally anticipated. They have, of course, had varying reactions throughout the country and have undoubtedly aroused greater caution on the part of mass distributors and indirectly, if not directly, influenced policy. Some of the laws have offered potential danger of backfire, as, for example, the Colorado chain-store tax law which was held to apply to a voluntary chain group. The loss of brokerage fees and discounts, a chief source of income for some of the voluntary groups, has not been in line with the expectation of sponsors of these laws. Then, too, the laws have contained loopholes, such as that in the Robinson-Patman Act, which permits sale to exclusive buyers at savings provided by the law. The growth of supermarkets may also be traced in part to tax laws on the number of stores in a chain which have indirectly encouraged fewer and larger stores.

Apparently the wave of legislation, which was generated in large part by depression psychology, has begun to subside somewhat, possibly because of reviving business, partly because of its failure to accomplish the desired results. A recent study in Michigan revealed the fact that large numbers of retailers were not even aware of the existence of fair-trade laws in their State.

Trade Association Activity.

Much, if not all, of the legislative drive of the post N. R. A. era owed its impetus to a new organization consciousness which the N. R. A. had generated among independent wholesalers and retailers, as well as among business and labor groups generally. Old trade associations were rejuvenated, new ones formed, and new members recruited on a greatly enlarged scale. Particularly strong national associations were forged in the drug and food lines. Many State and regional associations also took on new potency during this era. The average

wholesaler and retailer in the United States now holds membership in one or several trade associations. The very large distributor may belong to the local association in his field, to the State, and to the national organizations. In addition he may hold direct and indirect membership in such special-purpose organizations as the National Retail Credit Association, National Association of Credit Men, Chamber of Commerce of the United States, American Retail Federation, and American Management Association.

Local associations look to the average corner grocer or other small retailer or to the local wholesaler for the bulk of their membership. Local associations may have as few as 25 or less members although some have up to several hundred. State associations in the marketing field are frequently federations of local groups.

The largest national trade association as to membership is the National Association of Retail Grocers, which claims well over 40,000 food merchants; these are direct members in the State and local associations which comprise this federated organization. In size of staff and in scope of activities the National Retail Dry Goods Association probably holds first rank; approximately 50 persons serve the needs of the some 6,000 department and dry-goods stores which are members.

On the other hand, the largest distributors' association from the standpoint of number of affiliated State and local groups is probably the National Automobile Dealers Association, to which most of the more than 400 State and local associations of automobile retailers belong. The National Association of Retail Meat Dealers, formed in 1885, appears to be the oldest national trade association of retailers, while the pioneer wholesale group is the National Wholesale Druggist Association, formed in 1882.

The N. R. A. program encouraged the organization of hundreds of new local associations in the field of marketing and a small number of national groups, although a considerable proportion are not now as active as during the "industrial self-government" days of 1933–35. There are today about 3,500 associations of wholesalers and of retailers in the United States. In round numbers, 300 of these are interstate and 3,200 intrastate.

Of the 600 wholesale marketing associations, 200 are national and interstate, while 400 are State and local in scope. Only 100 of the 2,900 retail middlemen's trade associations are national and interstate.

In the absence of official statistics estimates must be relied upon to determine the growth in membership of these marketing associations. Between 1929 and 1939 the National Association of Retail Druggists expanded from approximately 22,000 to 28,000 members; the National Association of Retail Grocers from about 23,000 to over 40,000; the National Retail Dry Goods Association from 4,000 to 6,000 members, all in round numbers. In the wholesale field the Wholesale Dry Goods Institute has from 150 to 200 members with no change reported between 1929 and 1939; the National Electrical Wholesalers Association increased from 350 to 500 members between the above two dates; the National Food Brokers Association expanded from 850 to 1,000; and the National American Wholesale Grocers Association grew from 1,200 to 1,500 over the same period.[4]

While the motivation of this new urge for organization was deeply tinged by hopes of legislative action, the functions of these trade

[4] Data on trade associations supplied by C. J. Judkins, chief of the Trade Association Section, Bureau of Foreign and Domestic Commerce.

associations in the marketing field have been much broader. They have generally set themselves the goal of service to their trades. Some of them have engaged in the study of the internal management problems of their members with an eye to increased efficiency. Some have encouraged vertical cooperation among wholesalers, retailers, and manufacturers, or various combinations of these groups. Most of them have struck at unfair trade practices and attempted varying degrees of policing their industries. All of them hold frequent conventions for the purpose of enlightening their members on new developments in their trade, and promoting goodwill and greater homogeneity among their groups. Most issue bulletins, while some publish periodical journals. All of them engage, to a greater or lesser degree, in education and public-relations programs.

A most important phase of trade association work has been the interassociation activities of such groups as the American Trade Association Executives and the Council of National Wholesalers' Associations.

Of particular interest is the recently launched National Grocers Institute sponsored by the National Association of Retail Grocers. This institute, patterned in part after the British Institute of Certificated Grocers, seeks to serve the retail grocer through education on the job. The ideal is to make the grocer more efficient, better informed, and better able to cope with competition.

There is a very real field for constructive promotion of efficient marketing by these trade associations. Through the encouragement of research and constant emphasis on the utilization of improved methods uncovered by research, trade associations can do a great deal to raise the level of marketing efficiency and improve the competitive position of their members.

EFFECT OF THE STRUGGLE ON SIZE

Size of Manufacturing Establishments.

There is little or no direct statistical evidence which conclusively links the changes in distribution channels with changes in the size and economic strength of the dominant competing groups. Indeed there may be no such connection. It is nevertheless interesting to note what has happened to the three groups in the way of changes in size and strength. During the last half of the nineteenth century, manufacturing increased substantially in the volume of output from something over a billion dollars in 1849 to $13,000,000,000 in 1899. This achievement was accomplished by somewhat more than a fourfold increase in the number of factories and hand and neighborhood industries and by a substantial increase in horsepower consumption. Measured in terms of average wage earners employed, however, there was little evidence of change, the average number of wage earners per year in a single plant varying only from a minimum of 8 to a maximum of 12 with 1899 showing 10.3 as the average.

After the census of 1899, the enumeration of hand and neighborhood industries was discontinued. Approximately 305,000 establishments were included in the 19 industries which were classed as hand trades in that year and these establishments averaged two wage earners each. Excluding this group of establishments, the average number of wage earners in factories in 1899 was 22. By 1914 this average had

increased to 26 or to 39 if the 96,000 factories with products valued at less than $5,000 be excluded. On the latter basis the number of factory wage earners in 1929 averaged 42. In that same year, 11.5 percent of the wage earners were employed in factories with more than 2,500 workers each, 26.3 percent in factories with 501 to 2,500 employees, and 33.0 percent in factories with 101 to 500 workers. In other words, over 70 percent of all factory wage earners in 1929 were employed by plants which had an average of 101 or more employees each. At the other extreme, 45.4 percent of all manufacturing establishments employed between 1 and 5 wage earners and together accounted for but 3.2 percent of all workers. Much the same distribution prevailed in 1935.

In 1914, factories with products valued between $5,000 and $20,000 employed but 6 percent of all wage earners, while factories in the $100,000 to $1,000,000 class had nearly 43 percent of the wage earners, and those with over a million dollars employed 35.3 percent of the workers. This latter group had expanded by 1929 to a point where it employed 58.3 percent of all manufacturing wage earners, and accounted for 69.2 percent of the total value of all manufactured products, although but 5.6 percent of the manufacturing establishments fell in this class.

The evidence is clear that manufacturing establishments generally have been increasing in size and strength, at least up to 1929. It appears certain also that this growth has been paralleled by the exertion of more and more control over the channels of distribution by manufacturers as a whole. There has been variation between industries, and there are, as noted previously, instances in which wholesalers have been advancing in strength. On the other hand, there have been mergers in the food-manufacturing field, for example, which appear to have been prompted largely by hopes of increased efficiency from control over the marketing of the products. There are serious limitations on the possibilities of gain from this course both in theory and in practice,[5] but the tendency represents one clear example of a larger scale of manufacturing enterprise resulting from the desire for more direct control over marketing.

Wholesalers generally have lost ground and appear to be still losing business to direct distribution in most trades. On the other hand, large-scale retailing has become a more powerful factor in the distribution picture, the ultimate effect of which upon the manufacturers' position is as yet indeterminate. There is evidence in the statistics that chain stores have passed their zenith. Their rate of growth appears to have slowed down very markedly, whereas the rate of growth of independent retailers is decidedly on the mend, both in number of stores and in sales volume, if currently available series can be relied upon.[6]

Size of Wholesalers' Establishments.

As noted above it is necessary to look at the wholesaling picture in terms of what has happened since 1929 if a quantitative approach is desired. This is especially true of data on the size of the wholesaler's establishment and trends within the field of wholesaling. Whole-

[5] See N. H. Engle: Competitive Forces in the Wholesale Marketing of Prepared Food Products, Ph. D. thesis, University of Michigan, 1929, published by the National Wholesale Grocers' Association—The Bulletin, December 1929.

[6] Based on estimates of retail-chain and independent-store sales derived from projection of current series compiled by the Marketing Research Division of the U. S. Bureau of Foreign and Domestic Commerce.

salers, as distinguished from the many types of business which operate in the wholesale field, including the integrated wholesale departments of chains and other large-scale retailing business and the integrated wholesale branches of manufacturers and refineries, are of particular interest here since they have borne the brunt of the competitive struggle for control of marketing. There were in 1929 a total of 79,840 establishments classified as wholesalers with total sales of over 29½ billion dollars. Average sales were $370,000 while the average number of employees was about 11½ per establishment. In 1935, the nearest comparable classification of wholesalers revealed an increase to nearly 90,000 but with greatly reduced total sales of but $17,662,000,000. Average sales were below $200,000 per establishment and the average number of employees was about 8½ workers per establishment. Whether due to the influence of the depression, or to competition, or some other cause, wholesalers were on the average smaller-scale operators in 1935 than in 1929, although there was a substantial increase in their numbers.

More specific data on size for general or full-line wholesale merchants, the so-called typical wholesaler, in the leading wholesale trades of groceries, drugs, dry goods, electrical goods, and hardware reveal the pattern of distribution as well as changes between 1929 and 1935.

Grocery Trade.

Wholesale grocers selling a general line of commodities were found in both 1929 and 1935 with average sales ranging from $50,000 or less to $2,000,000 or more. (See table 1.) In 1929, 12 percent of the grocery wholesalers did less than $100,000 each annually, but together accounted for only 1.3 percent of total sales. Seventeen percent of the wholesalers had an annual volume of sales between $100,000 and $200,000 and did 4.6 percent of the business. At the highest sales level, nearly 4 percent of the establishments had sales of $2,000,000 or more each and did 28.6 percent of the total while 7.6 percent of all grocery wholesalers sold between $1,000,000 and $2,000,000 each and had 17.3 percent of the business.

The pattern for 1935 showed relatively little change. The total number of grocery wholesalers, contrary to the general trend for all wholesalers, had dropped from 4,776 to 3,210 and sales volume had fallen from $2,660,000,000 to $1,707,000,000, but only minor changes took place in the size distribution. The very large wholesalers with average sales in excess of $2,000,000 had fallen from 188 to 98 or from 3.9 to 3.1 percent of the total. From 28.6 percent of the total dollar sales these largest wholesalers dropped to 24.3 percent in 1935. There were no changes in the relative positions of the wholesalers doing less than $100,000 annually, while the other groups between these extremes, with one exception, registered slight gains. The $500,000 to $1,000,000 group dropped slightly from its 1929 position.

TABLE 1.—*Grocery wholesalers—general line—by size of business, 1929–35*

Size group (net sales)	1929				1935			
	Establishments		Net sales		Establishments		Net sales	
	Number	Percent	Amount [1]	Percent	Number	Percent	Amount [1]	Percent
Total	4,776	100.0	$2,660,450	100.0	3,210	100.0	$1,707,024	100.0
Under $50,000	215	4.5	5,321	0.2	85	2.6	2,934	0.2
$50,000 to $99,999	356	7.5	29,265	1.1	240	7.5	18,283	1.1
$100,000 to $199,999	815	17.1	122,381	4.6	591	18.4	86,737	5.1
$200,000 to $299,999	794	16.6	194,213	7.3	594	18.5	147,249	8.6
$300,000 to $499,999	1,052	22.0	404,388	15.2	741	23.1	287,663	16.9
$500,000 to $999,999	991	20.8	683,736	25.7	627	19.5	429,407	25.1
$1,000,000 to $1,999,999	365	7.6	460,258	17.3	234	7.3	320,062	18.7
$2,000,000 and over	188	3.9	760,888	28.6	98	3.1	414,689	24.3

[1] Figures in thousands.

Source: U. S. Bureau of the Census.

It is noteworthy that size appears to influence distribution costs in the grocery trade. The small volume dealers had relatively high costs in both 1929 and 1935. The group with sales between $200,000 and $300,000 had lowest operating costs relative to sales in both years. The larger houses showed increasing costs with the very large wholesalers having nearly as high costs as the very small.

Drug Wholesalers.

In the drug trade there was, in 1929, a total of 488 general-line wholesalers doing a combined business of $405,000,000. (See table 2.) Nearly 35 percent of these distributors sold less than $200,000 each that year, or combined sales of but 3½ percent of the total for all drug wholesalers. Large-scale druggists selling $1,000,000 or more each made up 28.1 percent of all units. The heavy concentration of business in the larger houses is revealed in the fact that they held 73.5 percent of the total volume. The changes registered between 1929 and 1935 reveal evidence of a trend toward larger size establishments. The total number of drug wholesalers had dropped from 488 to 274 and total sales were down to $298,000,000. The heaviest casualties appear in the ranks of those wholesalers with less than $200,000 sales volume. The total number here had been reduced from 169 to 36 or 13.1 percent of the total and these 36 did but 1.3 percent of the 1935 volume of business. Those drug wholesalers selling from $200,000 to $500,000 had dropped from 96 to 61 but the 61 made up a slightly larger percentage of the 1935 total. They dropped slightly in relative sales position, however, from 8.0 percent of the total in 1929 to 7.1 percent in 1935. The next larger group, those with volume between $500,000 and a million dollars increased in relative importance despite the loss of 16 firms. They made up 25.6 of all drug distributors and accounted for 17.2 percent of the sales. A loss of 30 establishments in the $1,000,000 and better, the very largest group, nevertheless, left the titans better off relatively than in 1929, with 39 percent of the firms and 74.4 percent of the business.

TABLE 2.—*Drug wholesalers—General line—by size of business, 1929–35*

Size group (net sales)	1929				1935			
	Establishments		Sales		Establishments		Sales	
	Number	Percent	Amount[1]	Percent	Number	Percent	Amount[1]	Percent
Total	488	100.0	$405,358	100.0	274	100.0	$297,784	100.0
Under $200,000	169	34.6	12,354	3.0	36	13.1	3,809	1.3
$200,000 to $499,999	96	19.7	32,396	8.0	61	22.3	21,308	7.1
$500,000 to $999,999	86	17.6	62,806	15.5	70	25.6	51,237	17.2
$1,000,000 and over	137	28.1	297,802	73.5	107	39.0	221,430	74.4

[1] Figures in thousands.

Source: U. S. Bureau of Census.

Dry Goods Wholesalers.

The picture in dry goods was somewhat similar to that in drugs although dry goods wholesalers suffered more serious losses as a group dropping from 848 houses with $566,000,000 sales in 1929 to 303 houses with $263,000,000 sales in 1935. (See table 3.) There were heavy losses in every size group with the very small houses losing relatively more ground. The large-scale operators with volume of $1,000,000 and over dropped from 104 in 1929 to 50 in 1935. Relatively they improved their position from 12.3 to 16.5 percent of the total houses and 69.5 to 74.3 percent of the total business. The total volume done by these large-scale houses, however, had fallen from $394,000,000 in 1929 to $195,000,000 in 1935.

General-line dry goods wholesalers have faced very heavy competition from direct selling manufacturers on the one hand, and from the direct buying chain, mail-order houses, and department stores, on the other. With few outstanding exceptions, they have been slow to evolve effective techniques for stemming the tide which has been flowing against all wholesalers. It has been more difficult to strengthen the position of the independent dry goods retailer in the face of the newer competition, and without retail outlets, even the stronger wholesalers have little hope.

Hardware Wholesalers.

Turning to one of the heavier industries, the hardware trade, the bulk of the wholesale business is handled by the larger firms although the very largest appear to be losing ground relatively. Out of 936 general-line hardware wholesalers in 1929 with combined volume of $664,000,000, 320 or over a third accounted for 83.1 percent of the total volume. Of these, 159 firms with sales of one million or more each, had nearly two-thirds of the total volume of business. (See table 4.) At the lower scale of operation, 376 wholesalers shared but 5 percent of the total volume between them. By 1935, there were 599 hardware wholesalers with $378,000,000 in sales, a substantial reduction from 1929. The largest group, those with $1,000,000 sales and over, had dropped from 159 houses with 66 percent of the sales to 84 with 57 percent of the sales. The $500,000 to $1,000,000 group increased their relative position from 16.9 to 19.2 percent of sales. The largest percentage of gain in sales position was found in the $200,000 to $300,000 group which rose from 4 to 7.3 percent of sales, although the

$300,000 to $500,000 houses also gained three points from 7.8 to 10.8 percent of all sales. The smaller of these two groups registered the only absolute gain over 1929 in both number of houses and dollar sales volume. Apparently the medium-size hardware wholesalers are meeting competition in this field somewhat better than are the very large houses.

TABLE 3.—*Dry goods wholesalers—General line—By size of business, 1929–35*

Size group (net sales)	1929				1935			
	Establishments		Net sales		Establishments		Net sales	
	Number	Percent	Amount [1]	Percent	Number	Percent	Amount [1]	Percent
Total	848	100.0	$566,374	100.0	303	100.0	$262,615	100.0
Under $50,000	161	19.0	4,057	.7	33	10.9	1,095	.4
$50,000 to $99,999	154	18.1	11,242	2.0	53	17.5	3,822	1.4
$100,000 to $199,999	143	16.8	20,527	3.6	57	18.8	8,156	3.1
$200,000 to $299,999	83	9.8	20,501	3.6	31	10.2	7,569	2.9
$300,000 to $499,999	88	10.4	34,902	6.2	37	12.2	14,615	5.6
$500,000 to $999,999	115	13.6	81,358	14.4	42	13.9	32,310	12.3
$1,000,000 and over	104	12.3	393,787	69.5	50	16.5	195,048	74.3

[1] Figures in thousands.

Source: U. S. Bureau of the Census.

TABLE 4.—*Hardware wholesalers—General line—By size of business, 1929–35*

Size group (net sales)	1929				1935			
	Establishments		Net sales		Establishments		Net sales	
	Number	Percent	Amount [1]	Percent	Number	Percent	Amount [1]	Percent
Total	936	100.0	$663,593	100.0	599	100.0	$377,568	100.0
Under $50,000	105	11.2	2,520	.4	24	4.0	[2] 665	.2
$50,000 to $99,999	115	12.3	8,619	1.3	63	10.5	4,483	1.2
$100,000 to $199,999	156	16.7	22,704	3.4	109	18.2	15,831	4.2
$200,000 to $299,999	108	11.5	26,664	4.0	113	18.9	27,452	7.3
$300,000 to $499,999	132	14.1	52,048	7.8	104	17.4	40,888	10.8
$500,000 to $999,999	161	17.2	112,017	16.9	102	17.0	72,418	19.2
$1,000,000 and over	159	17.0	439,021	66.2	84	14.0	[3] 215,831	57.1

[1] Thousands of dollars.
[2] Sales estimated for 2 establishments.
[3] Sales estimated for 49 establishments.

Source: U. S. Bureau of the Census.

Electrical Goods Wholesalers.

General line electrical goods wholesalers suffered drastic reductions both in numbers and in sales between 1929 and 1935, falling from 911 establishments with $414,000,000 sales to 386 with $184,000,000 sales. (See table 5.) In 1929 nearly 47 percent of the establishments had less than $200,000 each in sales, and they did but 9.8 percent of the total business. While 3.6 percent of the electrical wholesalers did $2,000,000 or more and accounted for 25.5 percent of total sales, those with sales in excess of $1,000,000 made up 11.4 percent of the wholesalers and handled 48.9 percent of the total business. The remaining

41.3 percent of sales was handled by 41.3 percent of the houses with average sales falling between $200,000 and $1,000,000.

By 1935 the pattern revealed substantial changes. The very small houses made up about 30 percent of the total and had 9.6 percent of the business, slightly less than in 1929. The $2,000,000 and over group lost the most ground, declining to 2.1 percent of the houses and to 11.8 percent of sales. Houses with sales between $1,000,000 and $2,000,000 improved their relative position slightly. The greatest gain was made by the establishments with average sales between $200,000 and $1,000,000 which by 1935 had increased to 59.6 percent of all establishments and to 53.7 percent of all sales. Electrical goods wholesalers have shared with dry goods distributors excessive competition from rival channels of distribution. Not only have the larger manufacturers established their own wholesale branches, but wholesalers in other lines such as hardware, furniture, and even dry goods and drug houses, have stocked electrical goods. In the retail field there has been the direct buying, not only of chains, mail-order houses, and department stores, but also the invasion of the utilities which have established retail appliance sales outlets in their various offices. All of this competition has tended to reduce the market for the services of independent general-line wholesalers of electrical goods.

In concluding this section on the effect of competition upon the size of wholesaling establishments there is no clear-cut trend indicated. In groceries, hardware, and electrical goods, the largest wholesalers have lost ground. In drugs and dry goods the large-scale houses have made slight relative gains, due possibly to their greater powers of resistance derived from their large volume and stronger capital position. It is perhaps more significant that all wholesalers have been losing ground in each of the leading trades than that certain shifts within the size pattern were noticed between 1929 and 1935. There is scarcely an adequate basis in the statistics for evaluating significant trends since cyclical factors have been in the ascendancy ever since 1929, and earlier data of a comprehensive character are lacking. The same limitation applies to the retailing analysis which follows.

TABLE 5.—*Electrical goods wholesalers—general line—by size of business, 1929–35*

Size group (net sales)	1929				1935			
	Establishments		Net sales		Establishments		Net sales	
	Number	Percent	Amount[1]	Percent	Number	Percent	Amount[1]	Percent
Total	911	100.0	$413,936	100.0	386	100.0	$183,660	100.0
Under $200,000	427	46.9	40,566	9.8	115	29.8	17,594	9.6
$200,000 to $499,999	253	27.8	82,373	19.9	167	43.3	55,346	30.1
$500,000 to $999,999	127	13.9	88,582	21.4	63	16.3	43,406	23.6
$1,000,000 to $1,999,999	71	7.8	96,861	23.4	33	8.5	45,651	24.9
$2,000,000 and over	33	3.6	105,554	25.5	8	2.1	21,663	11.8

[1] Figures in thousands.

Source: U. S. Bureau of the Census.

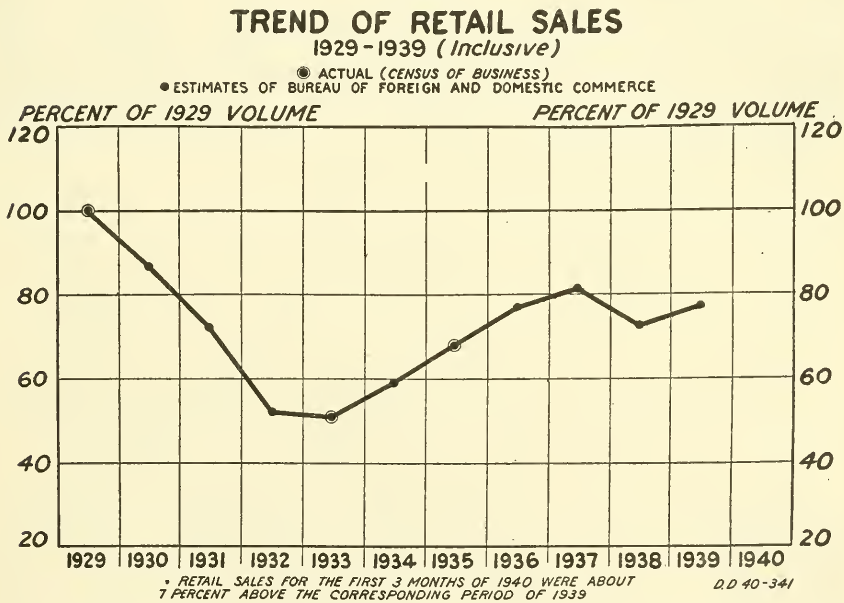
TRENDS IN SIZE OF RETAILING ESTABLISHMENTS

In discussing trends in size and type of retail outlets, reliance must be placed largely on data collected during the past 10 years. (See chart I.) In 1929 there were a million and a half stores in the United

States doing some $49,000,000,000 worth of business with a million and a half proprietors and some four and a half million employees. (See table 6.) In its struggle with the great depression, this retail army suffered heavy casualties. Business dropped off in dollar volume by nearly 50 percent and a million employees lost their jobs by 1933. Two years later retailing had made rapid progress toward recovery with over 100,000 more stores than in 1929, with sales in excess of $33,000,000,000 and with some 500,000 replacements in the army of employees, bringing the total well up to the 4,000,000 mark.

Retailing service is widespread and closely correlated to the needs of the people. In 1929 there was on an average 1 store for every 79 persons, or about 1 store for every 20 families. A slight drop in the total number of stores coupled with a continued increase in population

CHART I



brought the average for 1933 to 1 store for every 82 persons. The number of stores rose more rapidly than the population in the 2 following years, bringing the average up to 1 store for every 77 persons, the equivalent of about 19 families.

Changes in Average Size of Store.

Returning to the more comprehensive data dealing with size, the average retail store sold $31,827 worth of goods in 1929. (See table 7.) Depression sales averaged $16,406 per store, while the 1935 recovery carried the figure up to better than $20,000. These are over-all figures which need modification at a number of points in interest of clarity.

First of all these changes in dollar sales do not represent a corresponding change in the actual physical volume of goods handled because part of the difference was due to price changes. Existing retail price indexes cannot be used to determine the exact amount of

change due to that factor with any degree of accuracy but it is known that it was significant. For example, the decline in retail personnel was much less than in sales, which fact in itself is some evidence that the physical job of retailing remained larger than the sales drop indicated. Then, too, wholesale prices declined and retail prices usually follow sooner or later. To illustrate, wholesale grocery dollar sales fell off by 44 percent between 1929 and 1933. Price declines were responsible for three-quarters of the loss, as physical volume fell off by only 11 percent.

TABLE 6.—*General summary of retail trade, 1929, 1933, and 1935*

Item	1929	1933	1935
Number of stores (thousands)	1, 543	1, 526	1, 654
Sales (millions of dollars)	49, 115	25, 037	33, 161
Average sales volume per store	$31, 827	$16, 406	$20, 050
Population per store [1]	78. 8	82. 4	77. 1
Sales per capita	$400	$204	$270
Expense as percent of sales	21. 1	26. 0	22. 9
Proprietors	1, 510, 607	1, 574, 341	1, 511, 734
Employees (full- and part-time)	4, 402, 940	3, 433, 652	3, 961, 478
Average number per store	2. 9	2. 2	2. 4
Sales per employee	$11, 155	$7, 292	$8, 371

[1] Population based on midyear estimates of Bureau of Census.

Source: Bureau of the Census; Census.

TABLE 7.—*Percentage distribution of retail stores and sales, by size of store, 1929, 1933, 1935*

Size of store	1929			1933			1935		
	Percent distribution		Average sales per store	Percent distribution		Average sales per store	Percent distribution		Average sales per store
	Stores	Sales		Stores	Sales		Stores	Sales	
Total	100. 00	100. 00	$31, 827	100. 00	100. 00	$16, 406	100. 00	100. 00	$20, 050
$300,000 or more	. 98	25. 11	815, 492	. 34	17. 88	862, 720	. 51	20. 69	813, 405
$100,000 to $299,999	4. 05	20. 06	157, 643	1. 62	15. 03	152. 210	2. 25	17. 56	156, 477
$50,000 to $99,999	8. 35	17. 81	67, 886	3. 65	14. 96	67, 242	4. 40	15. 07	68. 670
$30,000 to $49,999	11. 45	13. 74	38, 193	5. 84	13. 35	37, 503	7. 31	13. 91	38, 152
$20,000 to $29,999	11. 24	8. 55	24, 210	7. 12	10. 41	23, 987	7. 90	9. 48	24, 060
$10,000 to $19,999	20. 27	9. 04	14, 194	17. 07	14. 52	13, 955	17. 69	12. 31	13, 952
$5,000 to $9,999	16. 48	3. 69	7, 126	18. 76	8. 15	7, 127	18. 47	6. 53	7, 088
Less than $5,000	27. 18	2. 00	2, 342	45. 60	5. 70	2, 051	41. 47	4. 45	2, 151

Source: Bureau of the Census.

In the second place, average sales conceal the variation within the different size groups. (See chart II.) In 1929 nearly 1 percent of the retail stores accounted for 25 percent of the total sales, with average sales per store of $815,492. This group included only those stores with sales of $300,000 or more each. At the other extreme, stores with sales of less than $5,000 each per year made up 27 percent of all stores but accounted for only 2 percent of the total volume of business. The average sales of these little fellows—the really small businessmen of the country—was but $2,342 per year.

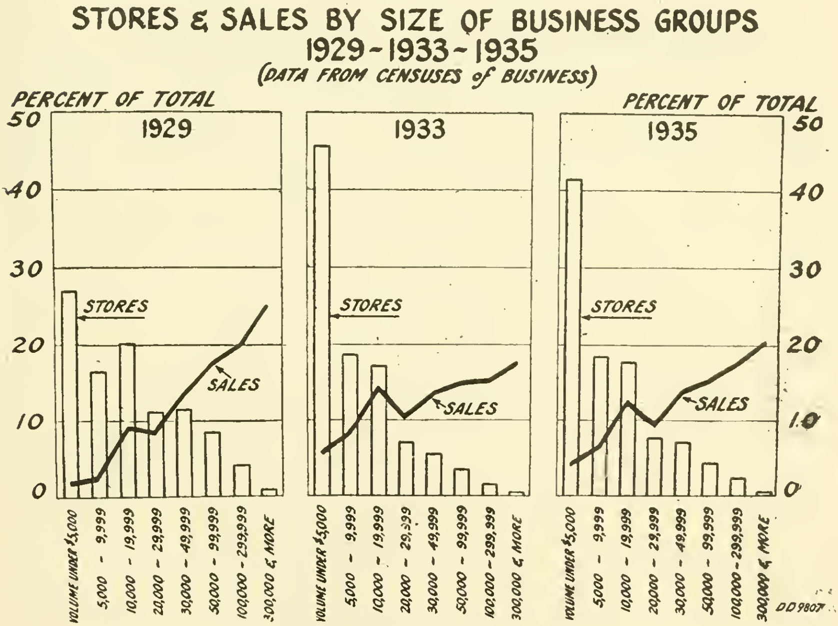
Trends in Size Since 1929.

By 1933 the very large stores, those with sales of $300,000 or more, made up but one-third of 1 percent of the total number of stores and accounted for less than 18 percent of all sales, a drop of more

than seven points from 1929. Average sales, however, had increased to \$862,720. Thus there were fewer, but on the average larger, stores in this group in 1933 than in 1929. The very small stores on the other hand had increased from 27 to over 45 percent of the total, with sales volume rising from 2 to nearly 6 percent of all retail sales. In general, the incidence of the depression appears to have been to increase both percentage of stores and percentage of business done by small-scale retailers and to reduce the percentage of stores and percentage of business for larger-scale stores. With the exception of the very large stores above noted, the average sales per store remained fairly constant for each size group.

The very large stores recovered slightly by 1935; from one-third to one-half of 1 percent of all stores falling in the group with sales of

CHART II



\$300,000 or more. Average sales for this group, however, had dropped to slightly below the 1929 level. The very small stores lost some ground but still comprised nearly 42 percent of all stores with nearly 4½ percent of all sales. Retail stores with sales of \$10,000 annually or less still accounted for 11 percent of all retail sales, while 60 percent of all stores fell in this group in 1935. While this was a reduction from the corresponding figures of nearly 14 percent of sales and over 64 percent of stores in 1933, these small stores remained substantially more important than in 1929 when they did less than 6 percent of the business with less than 44 percent of all stores. These figures tell a story of the changing pattern of retailing.

They represent the readjustments of a dynamic society to the changing tides of the business cycle. They indicate the virility of our people when faced with adversity. The general picture, to be sure, tells only a part of the story. A break-down of the facts as between

different lines of retail trade, and, more important, between different and competitive types of retailing is necessary to a full understanding of what is taking place in retailing. (See table 8 and chart III.) The different reactions of grocery stores, drug stores, automobile agencies, general stores, variety stores, and many others inject interesting variations into the theme.

NEW DEVELOPMENTS IN TYPES OF RETAILING

Chain Stores.

More important are the changes which are taking place in the types of retailing outlets. The struggle between chain stores and independents continues to play a dominant role. It is believed by some authorities that chain stores of the so-called regular or corporate type had reached or were rapidly approaching their zenith by the late 1920's. Prof. Paul H. Nystrom, of Columbia University, who is also president of the Limited Price Variety Chain Association, and an eminent authority on retailing, stated at the Seventh International Management Congress held in Washington that in his opinion the chains were rapidly approaching a limit or saturation point by the close of the last decade. This may have been true of the long-range trend of chain-store sales which had a very rapid and spectacular rise during the post-war era. Statistics are lacking to verify or disprove this contention as to the long-range trend. Cyclical factors have been dominant ever since adequate statistics have been available. They indicate that the chains maintained their relative strength until well into the present decade. In 1929 chains had 9.6 percent of all retail stores and did 20 percent of the business of the Nation. By 1933 they had relatively fewer stores, but accounted for 25.4 percent of the business. The 1935 Census revealed a decline to 7.7 percent of the stores and 22.8 percent of sales. In the drug trade the chains accounted for 18.5 percent of the business in 1929 and 25.7 percent in 1935. Since 1935 they have shown successive declines to 23.4 percent thus far in 1938, according to estimates by the Marketing Research Division of the Bureau of Foreign and Domestic Commerce. Estimates for grocery and combination stores indicate that the chains had arrived at a turning point in 1932–33 with 36.4 percent of sales. Since that time the relative proportion of grocery chain sales to total grocery sales has fallen to 33.1 percent, the estimate of the Bureau of Foreign and Domestic Commerce. (See chart IV.)

CHART III

TRENDS IN RETAILING
1929-1938

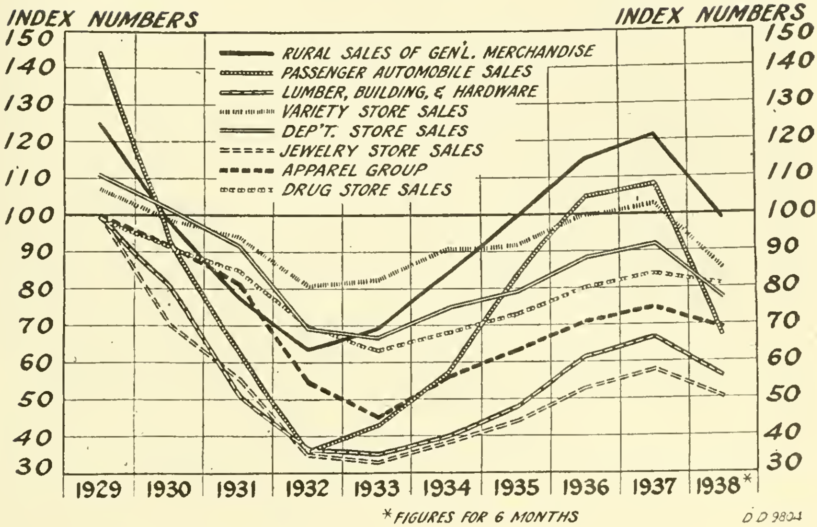


CHART IV

CHAIN STORE SALES PROPORTIONS
1929-1937

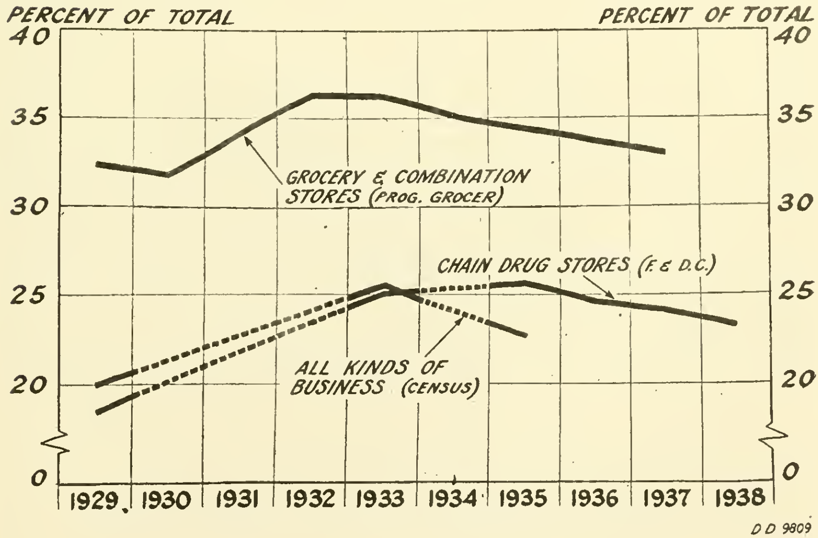


TABLE 8.—*Trends in retailing as shown by department-store sales, stocks, and collections; mail order, variety store, rural store and automobile sales, 1929–37*

	1929	1930	1931	1932	1933	1934	1935	1936	1937
Department stores:									
Sales, total United States, unadjusted, 1923–25=100 [1]	111	102	92	69	67	75	79	88	92
Stocks, total United States, end of month, unadjusted, 1923–25=100 [1]	100	94	82	66	61	65	64	67	76
Collections:									
Installment accounts, percent of accounts receivable [2]					14.9	16.6	16.7	17.1	16.6
Open accounts, percent of accounts receivable [2]					37.0	42.0	43.8	45.6	45.6
Installment sales, New England department stores, percent of total sales [3]	7.8	8.9	8.5	7.4	7.4	7.7	9.0	9.8	9.6
Mail order and store sales: Total sales, 2 companies (Montgomery Ward & Co., and Sears Roebuck & Co.) (thousands of dollars) [4]	61,249	55,225	47,214	38,344	39,775	49,639	59,878	74,520	83,924
Variety store sales: Combined sales of 7 chains, unadjusted, 1929–31=100 [2]	107.1	99.0	93.8	80.8	82.5	90.5	91.5	99.5	102.0
Rural sales of general merchandise: Total United States, unadjusted, 1929–31=100 [2]	124.9	97.8	77.4	63.1	69.2	83.7	99.4	114.8	121.7
Automobiles: New passenger automobile sales, unadjusted, 1929–31=100 [2]	144.1	93.0	62.9	35.5	43.3	57.6	83.8	105.1	108.3

Sources: [1] Board of Governors of the Federal Reserve System; [2] Bureau of Foreign and Domestic Commerce; [3] Federal Reserve Bank, Boston; [4] Reported to Bureau of Foreign and Domestic Commerce.
Data taken from: Supplement to Survey of Current Business, 1938.

TABLE 9.—*Number of chain stores and full-year sales, 1922, 1926, 1928*

Size of store	1922		1926		1928	
	Stores	Sales	Stores	Sales	Stores	Sales
	Percent	*Percent*	*Percent*	*Percent*	*Percent*	*Percent*
Total	100.0	100.0	100.0	100.0	100.0	100.0
Less than $25,000	14.9	1.9	13.3	1.6	13.3	2.0
$25,000 to $249,999	76.3	43.1	77.3	41.1	79.7	47.7
$250,000 and over	8.8	55.0	9.4	57.3	7.0	50.3

Source: Federal Trade Commission, Chain Stores; Size of Stores of Retail Chains, Washington, 1933, pp. 25 and 26.

With the trend toward saturation for chain stores has come a tendency toward larger stores. The Federal Trade Commission's Chain Store Investigation affords some evidence that the average chain store has been increasing in size since 1922. (See table 9.) More recently there is reason to believe that this trend has been accentuated by two sets of developments, one political and the other economic. The taxation of chain stores in many States has led to the reduction in the number of stores and the concentration of sales efforts in the remaining stores, emphasis well designed to increase the average size of stores. The economic development has been the appearance and rapid growth of super markets. While confined to the food trades, this new competition has caused many grocery chains to follow suit with giant food markets, another force in the direction of larger average sales per store. Statistics on these more recent shifts must wait another census or further sample studies, but there is some evidence that this movement has been of substantial proportions.[7]

The chain systems have had to contend with more than economic adversities since 1929. In addition to the special taxes levied against

[7] See W. L. Thorp: Changing Distribution Channels, op. cit., pp. 79–84.

them in several States, legislation, designed to cripple if not eliminate them, has appeared on the statute books of many States, and national legislation similarly aimed has been passed, with even more drastic laws in contemplation. It is argued by supporters of this type of legislation that chains are monopolistic in tendency and destructive of competition. Is this true? There is good evidence that chains had reached a saturation point several years ago. They also offer vigorous competition to each other. There has, moreover, been a continuous expansion in the number of independent stores in recent years, both in number and in volume. It is argued that this has been due to a large number of new stores replacing those which chains have driven out of business. There is now and probably always has been a very high degree of mortality among independent retailers. There is little evidence that it has been speeded up as a result of the chain competition. While these facts do not exclude the possibility of local monopoly situations, neither do they point to a general monopolistic tendency. The important questions from the standpoint of this analysis of trends in type of retail outlets is what is to become of the chains, and furthermore if chains are eliminated what types of retail outlet may be expected to replace them?

The answers to these questions are not clear but there is abundant evidence that chain-store competition has contributed to a more efficient retailing system. It has achieved this result directly by setting up standards of economy which have compelled competing stores to fall in line, to modernize, to reduce costs, and to lower prices to consumers. Indirectly the chains have contributed to a more efficient type of retail outlet by providing a training ground for independent merchants. Many efficient and successful independent retailers of today served their apprenticeships in chain stores.

Looking at these facts objectively, the student of marketing can only question seriously the wisdom of proposals to eliminate the chains on economic grounds. There may be social or other non-economic reasons for the anti-chain movement. To be sure, it is often pointed out that there are many abuses and unfair practices for which the chains are blamed. These accusations may have foundation, but before being accepted at face value they should be carefully scrutinized and weighed against such advantages as just pointed out. Legislation, if necessary, might then be directed only against manifestly unsound and unfair practices, among chains and independents alike. Should the chains be legislated out of business, however, they must inevitably be followed by some other modern system of retailing—perhaps super markets, an expansion of cooperative groups of retailers and wholesalers, or a greatly enlarged consumers' cooperative movement. In any event it seems clear that any widespread departure from mass merchandising would be impossible without accepting retreat to an outmoded economic system with neither large-scale production nor mass distribution.

Super Markets.

In the food field there has appeared a new competitor for marketing honors in the form of gigantic food markets. Quickly recognized as an important contender for a place in the sun, these super markets have made rapid progress during the depression. Characterized by large buildings, with mammoth stocks of merchandise displayed prominently and marked with what appear to be low prices, heavily

advertised, with parking facilities but no other service, these new food outlets have given the chains in particular very sharp competition.

Apart from the breathtaking size of these undertakings there is little to distinguish them from the self-service, cash-and-carry chain store. They have merely out-chained the chains by their adoption of mass-merchandising technique. Indeed, as has been noted earlier, many of the chains have gone in for super markets themselves, a transition which requires very little change in traditional chain-store policy. No official statistics are available on the exact extent of the super markets.

Department Stores.

One of the earliest types of retail outlet to attempt large-scale distribution, the department stores in this country continue to provide a significant channel for the mass movement of commodities. They are essentially large-scale units, relatively few in number.

There were some 4,200 department stores reported by the census in 1935 with sales of nearly three and one-third billion dollars. While there is census data for only 3 years, 1929, 1933, and 1935, the Federal Reserve Board has provided an index of department-store sales for many years. A comparison of estimated total sales of department stores with estimated total retail sales since 1929 indicates some measure of stability for that type of retailing. (See table 10 and chart V.) Department stores accounted for 8.9 percent of the total retail volume of the country in 1929. Like the chains, department stores showed a remarkable ability to adjust themselves to depression conditions. They improved their relative position in the retail structure to 10.6 percent of total sales in 1932. Since then the relative strength of department stores as reflected in percentage of sales diminished until a low point of 9.7 percent was reached in 1936. A slight recovery in relative strength is indicated for more recent years. There is some slight evidence in these comparisons of an inverse correlation between department store sales and changing business conditions. The data indicate a tenacity in the face of adversity which should exert a significant stabilizing influence on retail trade.

These sales data do not reveal the whole truth, however as a glance at net operating results quickly reveals. (See table 11.) Net operating losses rather than gains were characteristic of the depression years, with 1932 representing the nadir. Recovery of net earnings was not perceptible until 1934, after which there were increases through 1936. Results for 1937 reflected the depressing experience of the recession of the last half of that year in reduced net earnings.

No discussion of department stores would be complete which failed to comment on the rising level of department-store costs. Studies by the Harvard Bureau of Business Research provide well-known evidence of this trend. There appears to be a tendency for costs to increase as sales volume increases after the volume has reached substantial proportions. (See chart VI.) Other closely related reasons are the expansion in expensive services and the addition of new departments.

CHART V

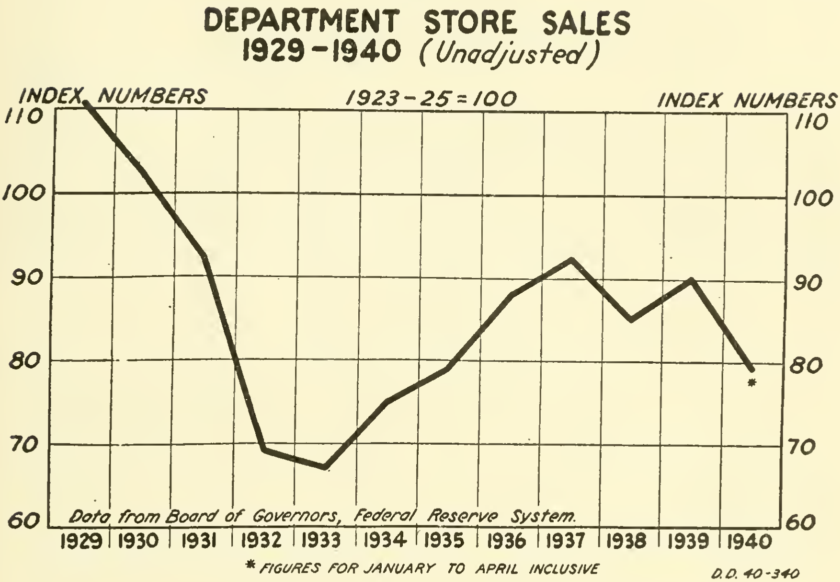


CHART VI

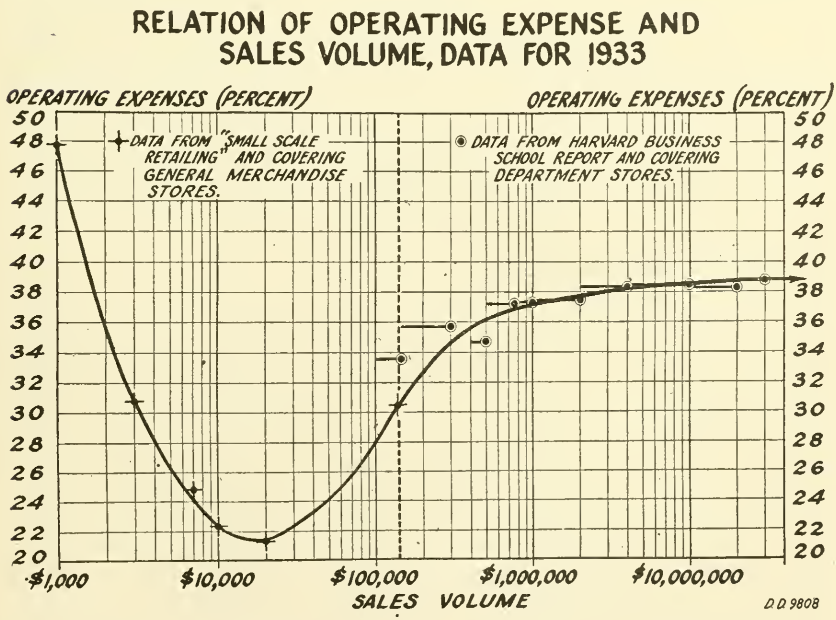


TABLE 10.—*Department store sales, 1929–39*

Year	Total retail sales, millions	Department-store sales: Estimated by Bureau of Foreign and Domestic Commerce		Department-store sales: Bureau of the Census	
		Millions	Percent	Millions	Percent
1929	$49,115	$4,350	8.9	$4,351	8.90
1930	42,849	3,997	9.3		
1931	35,414	3,606	10.2		
1932	25,597	2,704	10.6		
1933	25,037	2,538	10.1	2,538	10.10
1934	29,188	2,841	9.7		
1935	33,161	3,311	10.0	3,311	9.98
1936	37,940	3,688	9.7		
1937	39,930	3,856	9.7		
1938	35,425	3,562	10.1		
1939	37,950	3,772	9.9		

TABLE 11.—*Net operating results, percentage of sales, in department stores, 1930–37*

Size of business groups	1930	1931	1932	1933	1934	1935	1936	1937
$500,000 to $1,000,000	−1.9	−3.3	−7.9	−0.7	1.3	1.7	2.2	2.0
$1,000,000 to $2,000,000	−1.7	−2.8	−6.6	.4	.8	1.9	2.2	1.4
$2,000,000 to $5,000,000	.0	−1.8	−5.3	−.8	.1	1.9	2.8	1.9
$5,000,000 to $10,000,000	.7	−1.2	−5.5	−1.5	.4	1.1	2.1	1.4
Over $10,000,000	.5	−2.2	−6.1	−1.1	−.6	1.3	2.2	1.0

Source: Controllers' Congress of the National Retail Dry Goods Association.

Mail-Order Houses.

Department stores and chains do not exhaust, by any means, the types of retail outlets in which changes are occurring. (See chart VII.) Mail-order houses afford one of the most intriguing phases of retail distribution since they combine in their current organization many of the characteristics of chains and department stores. The leading companies in this field have achieved no little success from their venture into the department-store field. They have also established tire and automobile accessory stores operated on the chain-store pattern. At the same time the mail-order business has been continued, but efforts have been made to limit it to territories not served by branch stores.

Consumer Cooperatives.

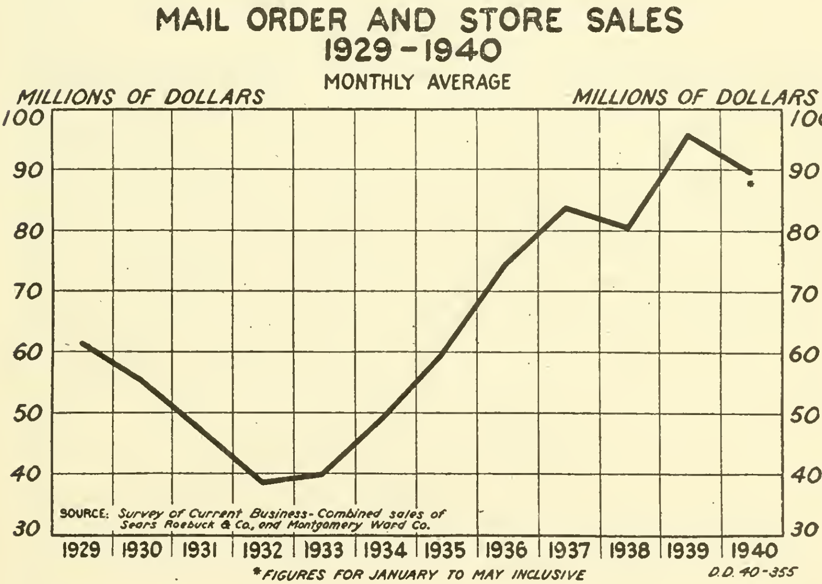
The upsurge of interest in consumer problems necessitates brief mention of consumer cooperatives in this discussion of retailing. The movement has had widespread success in England, in Sweden, and in other European lands. In the United States its history dates back over a century. Its progress has been very limited in this country. With all the interest expressed in consumer cooperation in recent years the total volume of business done by consumer cooperatives is less than 2 percent of total retail sales. The reasons for the small scale of this movement are not far to seek. Retailing in the United States has been highly competitive and on the whole quite efficient. The competitive thrust of mass distribution has kept prices down to such a level that the cooperatives have found little opportunity to do a better job. In a few communities, usually where

racial or religious homogeneity prevails, the movement has been successful. In a few lines of merchandise such as gasoline, farm supplies, and college textbooks, the consumer cooperatives have made some headway. But in the main they remain an insignificant factor in the struggle for control of American marketing machinery.

The Independent Retailer.

There are two significant trends in retailing that are designed to strengthen the position of the independent merchant. The first of these is the cooperative chain movement, which may more accurately be called distributive cooperation. This movement has spread widely in the grocery trade, sometimes sponsored by wholesalers and sometimes strictly a retailer's cooperative effort. The very growth

CHART VII



of the system is some evidence of its utility to intependent retailers to whom it offers some of the advantages of the corporate chains while permitting the retention of a substantial measure of independent autonomy. The second trend is the rapid appearance of neighborhood shopping centers with adequate parking space for automobiles. These centers are springing up in many cities and apparently attracting a large volume of patronage. While chain stores are not excluded from the center, it is common to find independent drug stores, bakeries, delicatessens, hardware stores, and many others.

In conclusion of this section, it appears that one of the most significant changes in retailing is the tendency away from specialization. With this is coupled a trend toward larger-scale operations on the part of mass distributors, and some expansion of small-scale independents. There appears to be a recrudescence of the old general-store concept in retailing. To illustrate, department stores experimented with grocery departments a number of years ago. The

experiments proved unprofitable and the idea was abandoned and for a number of years grocery and food departments were rarely, if ever, found in department stores. More recently new ideas—possibly the result of competition—have led to the reestablishment of grocery and food departments in department stores throughout the country on a much wider spread basis than was ever true in the past. Another example is the growth of men's clothing departments in the department-store field. Time was, not so many years ago, when the average man would no more think of going into a department store to buy a suit of clothes than he would think of flying to Europe. Now both concepts are accepted. There is no factual data on this trend for earlier years, but a study has been made of the sales of men's clothing by department stores which is very illuminating for recent years. In 1929, out of total sales of men's clothing of 767 million dollars, 82.5 percent was sold through men's clothing and furnishing stores and 17.5 percent through department stores. By 1933, these percentages had changed to 77.7 for men's clothing stores and 22.3 for department stores. Four years later department stores were accounting for 23.5 percent of the total. These figures give clear indication of a significant competitive change in men's buying habits.

The foregoing cases are typical of what has taken place on a wider scale throughout the entire field of retailing. In grocery distribution there has been a marked tendency away from the old specialized grocery store to combination stores which handle groceries, meats, and produce. The development of super markets is only the latest stage in this trend toward complete food stores under one roof where Mrs. Consumer can get all her staple groceries, her meats, her bakery goods, her dairy products, and her fresh fruits and vegetables at the same time. The widespread use of the automobile for shopping is a contributing factor here since parking difficulties make one-stop shopping centers with adequate automobile space very attractive to the buyer. In the drug field, the common jokes about the odd items one can get at the corner drug store are founded on the fact that drug stores are rapidly becoming general stores, with their fountains and food departments, cigarette and tobacco departments, camera and photographic supplies, their books, periodicals and newspapers, as well as a host of other commodities unrelated to the original business of dispensing drugs.

This general and widespread recrudescence of the old general-store concept appears to be the result of competitive forces at work in the field of retailing. How far this move will continue and whether it will ultimately be replaced on the return swing of the pendulum by more specialization, no one can say at this time. It should be pointed out, however, that specialization in merchandising as well as in production tends for more efficient methods and for lower costs of operation. Unless the more generalized operations can bring about new types of economies in distribution which will cut costs and enable the consumer to supply his wants at lower prices, they cannot be easily justified nor can they be expected to prevail in the long run.

PROFITS IN MANUFACTURING, WHOLESALING, AND RETAILING

What effect, if any, has the struggle for control of marketing channels had on the profits earned by the competing groups? Evidence is not available to answer this question conclusively. A few studies

of profits have been made, chiefly of incorporated companies. Ralph C. Epstein's study of "Industrial Profits in the United States" based upon analysis of special tabulations of Federal income-tax returns, presents profit data for selected large and small corporations in the fields of manufacturing, wholesaling, and retailing for the years 1924–28. While not perfectly satisfactory these data are offered as being on the whole the best available break-down for this analysis. For large-scale corporations in each group, his sample contains identical corporations while for the small corporations the number varied from year to year.

The data indicate that small manufacturing corporations, defined as those with average capital of $171,000 earned slightly higher profits on total capital than did large corporations (with average capital of $13,500,000). (See table 12.) The 5-year average was 11.2 percent for small corporations and 10.4 for the large ones. Large wholesaling corporations with average capital of nearly $2,000,000 averaged profits of slightly over 9.1 percent of total capital in the years 1924–28. In 1924 the 397 small wholesale corporations with average capital of $138,000 earned 12.4 percent on their capital, while in 1928 there were 308 small wholesale corporations with the same average capital earning 10.9 percent. Data for intermediate years are not available but for the 2 years 1924 and 1928 the smaller corporations had definitely higher earnings than the larger ones. The contrary was true of retail trading corporations of which there were 283 large-scale identical companies with average capital of $6,800,000 earning an average of 14.3 percent profits. The small-scale retail corporations (average capital $89,000), numbering 742 in 1924 and 858 in 1928, averaged 12.1 percent profits of their total capital or over 2 points below the larger operators.

TABLE 12.—*Profit as percentage of total capital wholesale, retail, and manufacturing corporations, 1924–28*

Year	Wholesale trade		Retail trade		Manufacturing	
	Large	Small	Large	Small	Large	Small
1924	9.8	12.4	14.4	12.3	9.5	10.8
1925	9.5		15.2		11.4	11.1
1926	9.4		14.6		11.7	11.4
1927	8.5		14.3		9.0	11.3
1928	8.5	10.9	12.9	12.0	10.4	11.3

Source: Epstein, R. C.: "Industrial Profits in the United States." National Bureau of Economic Research, 1934.

In selected manufacturing lines the small-scale corporations appear to have had slightly higher earnings in foods, chemicals, textiles, metals, and rubber over the 4-year average (see table 13). Earnings, moreover, fluctuated somewhat less from year to year among the smaller companies.

In the wholesale grocery trade small-scale corporations had higher profit ratios than the large-scale units in each but one of the 5 years under consideration. (See table 14.) Large-scale drug wholesalers showed the reverse with higher returns on capital in each year but one than were reported by the small-scale corporations. Small-scale dry-goods corporations showed higher returns in 3 out of 5 years and

averaged higher profits over the entire period. In the hardware trades, small-scale corporations were in the profit lead each year but one.

In the retail grocery trade profits of large-scale corporations, which no doubt included the larger chains, showed much higher ratios than those of the smaller retailers, the 5-year averages being 21.9 and 12 percent, respectively. (See table 15.)

Small-scale dry-goods retailers, however, reported higher profit ratios in each year than did the large-scale firms with a range from 13.3 percent in 1928 to 15.5 percent in 1925, as compared with a low of 9.8 percent for large-scale corporations in 1924 and a high of 11.2 percent in 1925. Large-scale department stores showed consistently better profit ratios than did the small corporation, but at the same time revealed a persistent downward drift from 11.9 percent in 1924 to 8.8 percent in 1928. The smaller department stores averaged about 8.4 percent and showed no indication of a trend. In the furniture trade small-scale corporations had higher profit ratios in 3 out of the 5 years and averaged slightly higher for the entire period. The same was true of small-scale corporations operating in the retail building materials and hardware trade.

TABLE 13.—*Manufacturing corporations—profit as percentage of total capital, selected industries, 1924–28*

	Foods		Chemicals		Textiles		Metals		Rubber	
	Large	Small	Large	Small	Large	Small	Large	Small	Large	Small
Number of corporations	215	(1)	210	(2)	289	(3)	648	(4)	26	(5)
Year:										
1924	10.1	12.1	8.9	15.3	6.6	10.7	9.2	10.6	6.8	9.7
1925	9.3	13.9	11.8	13.2	9.1	11.3	11.3	10.6	15.7	14.7
1926	10.9	12.0	11.6	13.8	7.0	9.6	12.2	11.2	7.6	16.2
1927	9.7	10.1	7.3	12.0	8.9	11.6	9.3	11.1	6.4	12.0
1928	10.3	10.5	11.1	9.7	6.6	9.8	10.4	13.1	2.3	12.4

[1] Number varied from 220 to 293.
[2] Number varied from 84 to 110.
[3] Number varied from 191 to 247.
[4] Number varied from 336 to 373.
[5] Number varied from 11 to 15.

Source: Epstein, R. C.: "Industrial Profits in the United States." National Bureau Economic Research, 1934.

TABLE 14.—*Wholesaling corporations—profit as percentage of total capital [1]—selected trades, 1924–28*

Year	Grocery		Drug		Dry goods		Hardware	
	Large [2]	Small [3]	Large [2]	Small [3]	Large [2]	Small [3]	Large [2]	Small [3]
1924	10.8	9.9	11.7	7.7	7.4	10.1	6.7	8.9
1925	9.3	10.3	11.4	10.4	9.1	11.4	8.5	8.2
1926	7.7	9.0	10.9	10.5	7.0	7.6	7.6	7.7
1927	7.8	8.7	9.8	12.4	9.1	8.6	7.6	8.0
1928	7.3	10.9	10.3	8.8	8.4	6.8	8.5	9.4

[1] Source: Epstein, R. C.: "Industrial Profits in the United States." National Bureau Economic Research, 1934.
[2] Based on data for large identical wholesale trading corporations, 59 grocery, 25 drug, 29 dry goods, and 43 hardware.
[3] Nonidentical small wholesale trading corporations, ranging from 78 to 97 grocery, 29 to 49 drug, 39 to 49 dry goods, and 48 to 49 hardware corporations.

TABLE 15.—*Retailing corporation—profit as percentage of total capital—selected trades, 1924–28*

	Grocery		Dry goods		Department stores		Furniture		Building materials and hardware	
	Large	Small	Large	Small	Large	Small	Large	Small	Large	Small
Number of corporations	14	(1)	27	(2)	93	(3)	12	(4)	27	(5)
Year:										
1924	23.5	16.0	9.8	14.7	11.9	8.4	14.3	10.7	10.7	8.7
1925	21.0	8.9	11.2	15.5	11.7	9.1	7.9	10.2	11.6	11.3
1926	21.7	13.0	11.1	14.4	11.4	8.8	7.4	11.2	10.0	11.1
1927	21.8	9.1	11.0	14.1	10.7	7.8	8.9	10.4	8.2	9.5
1928	21.3	13.1	10.6	13.3	8.8	8.4	9.6	7.2	8.4	10.6

[1] Number varied from 81 to 92.
[2] Number varied from 81 to 96.
[3] Number varied from 87 to 93.
[4] Number varied from 41 to 48.
[5] Hardware only. Number varied from 41 to 48.

The foregoing data on profits are inconclusive and have only indirect bearing on the problem of the influence of changing channels of distribution on size. They may be the more significant because of the absence of definite trends. However, they need to be supplemented by additional studies, over a longer range of time and with samples selected specifically for the purpose. Until such time as more and better data are available, the case must rest on existing evidence. This evidence does indicate that large-scale retailing has been able to earn a higher return on capital than either large- or small-scale manufacturing or wholesaling. (See table 12.) It also appears that small-scale wholesaling and small-scale retailing corporations earned higher profits on capital than did large-scale wholesaling or large- and small-scale manufacturing corporations. Manufacturing corporations large and small had higher profit ratios than large-scale wholesalers. Finally there is some indication of a downward trend in earning ratios of both large-scale wholesalers and large-scale retailers between the years 1924 and 1928 which may be significant because of the fact that those years were generally characterized by increasing business activity, the so-called expansion stage of the business cycle.

SUMMARY AND CONCLUSION

The foregoing examination of what is taking place in the channels of distribution reveals, if anything, the fact of a keenly competitive struggle. From this struggle, manufacturers appear to be increasing in size and strength with a growing resort to more direct channels of marketing. Retailing appears to be thriving with a growing tendency toward larger scale units handling a wider variety of merchandise. The large-scale retailing outlets appear to have expanded about as far as present demand for their type of services justify. Chains appear to have reached their height and to be consolidating their positions, subject of course to freedom from further political aggression. Department stores have run into rising costs which may well hold them in check, unless they can revise their techniques and avoid the race for expensive service to customers. Mail-order houses have shifted their base and are rapidly entering the field of department-

and chain-store operation. Here they find the same limiting factors which chains and department stores have encountered. Super markets have had a lush growth but would appear to differ but little fundamentally from self-service cash-and-carry chain grocery stores. They are much larger, carry a wider range of merchandise, but they cater to the same market, the customer with cash who is willing to provide his own service in selecting his goods and in getting them home. The same forces which circumscribe the chains would appear to limit the expansion of super markets. They are essentially a competitive factor which limits the chains and in turn may be limited by the chains.

The independent merchant is showing his ability to survive and even to increase in numbers and in relative sales volume. There are some trades which have suffered losses but there are others which have made distinct headway in the face of competition. The cooperative movement among distributors is a bulwark to their survival in certain lines, notably foods. Consumers' cooperatives have made practically no impression on the retailing structure of this Nation as a whole. In a few lines, notably gasoline, and farm supplies, and in a few limited areas of the country there is a successful movement. It is not a serious competitive contender for the responsibility of doing the Nation's marketing as yet, nor is the outlook encouraging to consumer cooperators.

The wholesalers alone of the three major competitive groups have lost ground. Their future is closely identified with that of their customers, the independent retailers, and the smaller industrial and institutional buyers. There is a very large volume of business and a substantital measure of employment now existing in the wholesale field. Wholesalers have well-organized trade associations which are striving to provide leadership out of the difficulties of recent years. There will probably remain a comparatively large area in which wholesalers will continue to function as the most efficient type of marketing channel. By so doing they will contribute to a balance of power between manufacturers and retailers in the struggle for control of marketing channels and functions.

CHAPTER XVI

RESALE PRICE MAINTENANCE—AN ECONOMIC SUMMARY[1]

DEFINITION AND CLASSIFICATION

Resale price maintenance may be defined as that system of distribution under which the manufacturer of trademarked or otherwise identified goods names the prices at which its products shall be sold and distributed by wholesalers and retailers, thus controlling the margins realized by distributors and the prices paid by consumers.[2]

Among the methods of resale price maintenance that have been employed are the following:[3]

(1a) The manufacturer furnishes to the distributor a list of prices regarded as desirable, with the suggestion that such prices be maintained. Only persuasion is employed to secure the observance of the suggestions.

(1b) The same price suggestions are made, but, in addition, the manufacturer refuses to sell to distributors who cut below these prices.

(1c) Refusal to sell is supplemented and implemented by active policing, with or without cooperation of complying distributors.[4]

(2) Maintenance by the manufacturer of agencies or pseudo agencies whereby ownership of the goods does not pass from him until final sale to the consumer. This method is lawful where actual agency exists,[5] but unlawful where the agency method is but a subterfuge.[6]

(3) Retail outlets that are owned and operated as manufacturers' branches. Under this method no intermediaries exist, hence no resales take place. There is no question as to lawfulness of this method.

(4) Contracts between the manufacturer and his distributors in which the actual or the minimum resale price is stipulated. It is around this method that controversy has raged, and toward the legalization of which much legislation has been enacted.

WHY PROPONENTS WANT LEGALIZATION OF RESALE PRICE MAINTENANCE

Retailers.

It is generally believed that the strongest pressure for resale price maintenance is exerted by the manufacturers of nationally advertised goods. There have been examples of such origins, but they have been

[1] This chapter was written by Dr. Earl D. Strong, who was requested by the economic coordinator of the T. N. E. C. to summarize the fragments of available evidence on perhaps the most notable governmental activity made on behalf of small business in recent years; i. e., price-control legislation.

[2] U. S. Federal Trade Commission. Report on Resale Price Maintenance, pt. 1, p. 2 (1929).

[3] Methods (1a) and (1b) have always been regarded as legal, but (1c) was adjudged unlawful in the *Beech-Nut case*, where elaborate methods for detecting and reporting violations were involved.

[4] *F. T. C.* v. *Beech-Nut Packing Co.* (257 U. S. 441 (1922)).

[5] *U. S.* v. *General Electric Co.* (272 U. S. 476 (1926)).

[6] *Dr. Miles Medical Co.* v. *Park & Sons Co.* (220 U. S. 373 (1911)).

262652—41—No. 17——14

exceptions to the general situation. The real source of nearly all recent propaganda and pressure is to be found among retailers and their associations, especially in the drug trade. The wants of these groups will, therefore, be considered first.

In the current anemic spirit of industry and trade the traditional drive for profits, with their accompaniment of hazards, seems to have given way, in large measure, to a search for security. Retailers display this new emphasis in their fear of price competition. They wish to be assured of adequate margins between their buying and selling prices regardless of efficiency or of services rendered. Resale price maintenance is publicly advocated as a "fair trade" methodology; in reality it is a margin-maintaining measure.[7] Its retailer friends do not want to compete with each other in the matter of price.

It is usually claimed, however, that resale price maintenance is needed in order to prevent "loss leader" selling. This merchandising device offers or purports to offer a selected list of well-known and commonly used items at much less than customary prices and, it is often claimed, at less than cost, in order to attract to the store customers who may be induced to buy other articles that give a profit to the seller. This type of sales building is frequently employed by chains, department stores, and cut-rate independents, and is strenuously opposed by most of the smaller dealers.

In addition to the general dislike of price competition, there are specific reasons for the opposition to loss-leader selling. Because it is used as "bait" to attract customers it deprives the price-maintaining competitors of the sale of other goods as well as of the leaders, unless they meet the competition. They claim that purchasers, frequently ignorant of quality, are led to believe that all prices of the loss-leader store are low prices. They see less opportunity for themselves in offering more service and better quality of goods. They think that loss-leader selling has a "snowball" effect and that prices will have to be cut on more and more goods to meet customers' ideas as to proper price levels in the trade. If they do not meet the low prices they are deprived of the sale of the most attractive items of trade—nationally advertised goods—which require less selling effort and have a more rapid turn-over. It should be said, however, that there is not much agreement as to what actually constitutes loss-leader selling, and that little convincing evidence has ever been assembled to show that it is significant in amount or essentially detrimental to consumers.

But the reasons why resale price maintenance is wanted go beyond opposition to loss leaders. Many independents fear that monopolistic power possessed by mass distributors will, in spite of the Robinson-Patman Act and the various State unfair practices acts, react to the detriment of small retailers. Anything, such as resale price control, that will weaken the ability of chain stores and other large price cutters to attract patronage will, conversely, aid the independents in their struggle. The zeal for price control is, in part, one manifestation of the intense hostility to the newer forces of distribution. (But it is significant that chain stores are now supporting resale price maintenance in the drug field.)

One reason seldom advanced in trade-association publicity, but readily found in the arguments to the trade itself, is the necessity

[7] Testimony of Representative Emanuel Celler of New York before a subcommittee of the Committee on the Judiciary of the United States Senate, 75th Cong., 1st sess., on S. 100. Resale Price Maintenance.

of securing and maintaining generous profit margins on as much business as possible. The drug trade has suggested a 33⅓ percent margin on the retail price as fair; of course this means a 50-percent margin on the invoice price. Nationally advertised goods of general demand afford the best possibilities of such margins if the proper controls are established.

Wholesalers.

Wholesalers want resale price maintenance for much the same reasons that retailers do. They don't like competitive price-cutting and they do like to be assured of adequate profit margins. They share the retailers' fear of chains and great department stores, for such institutions tend to eliminate wholesalers. They are disturbed about the dangers that may arise from low prices given by manufacturers to mass distributors which may not be available on a competitive basis to wholesalers, and hence favor methods that will prevent these mass distributors from cutting prices to consumers and that will thus diminish the pressure by small retailers for low prices from wholesalers. They fear that direct selling by manufacturers to large outlets may lead to a practice of direct selling to the smaller stores and thus bring about a further reduction in the business of wholesalers.

The main reason, however, for wholesalers' concern with resale price maintenance is that their whole fortune is bound up with the retailers. They must keep the goodwill of retailers, so whatever the retailers favor the wholesalers will favor. And if independent retailers are prosperous, their prosperity will tend to spread to the wholesalers.

Manufacturers of branded goods.

It should not be assumed that manufacturers, even of nationally advertised and trade-marked goods, are unanimously and wholeheartedly in favor of resale price maintenance. Some support it merely to keep the goodwill of distributors by helping them to get what they want; others believe that enough direct advantages exist to justify support; many are totally indifferent or in active opposition. In the main, manufacturers of trade-marked goods are on the affirmative side.

Specific reasons held by manufacturers who favor price control may be enumerated briefly:

(*a*) Price-cutting breaks down to some degree the product differentiation that has been expensively created, reduces consumers' faith in the quality of the product, and substitutes the pull of low prices for the push generated by advertising. Accepted qualities of alleged uniqueness tend to break down in the struggle of heterogeneous price competition.

(*b*) The goodwill of the retailer is important even to manufacturers of advertised products. He will push those goods that give him good margins and ignore or disparage those that provide only small ones. The assurance of adequate margins is, then, the strongest inducement that the manufacturer can offer to secure the cooperation of the retailer.

(*c*) Manufacturers, like others, have no great love for low prices as such. Prices once cut are hard to raise again. If price-cutting begins, it may lead to destructive competition, both from com-

peting manufacturers and among distributors, who then press for higher margins and lower prices from the manufacturers.

It is not too difficult to persuade manufacturers to participate in resale price-maintenance procedure.

ECONOMIC AND SOCIAL REASONS FOR RESALE PRICE MAINTENANCE

In suggesting valid arguments for price control there is intended no attempt to justify the forms that have been legalized, nor any particular form. Further, there is no intention to imply that the arguments are powerful and convincing, or the reverse. It is believed, however, that there exist certain bad situations which demand a remedy, although not necessarily by Government intervention.

Numerous studies have shown that many retailing trades suffer from high mortality, especially among the smaller units. There are many causes, among which is to be found the inability to get adequate margins on sales. Whether this be due to inefficiency of the dealers, too many competitors, or the very effective competition of the newer and larger types of competitors is not clear. It is clear, however, that numerous and scattered small retailers offer definite conveniences to the consuming public. It is equally clear that a large casualty list in business involves heavy economic waste. And finally, there is ample evidence to sustain the charge that many examples of unfair competition have existed and continue to exist.

It seems obvious that resale price maintenance will tend to eliminate one of the factors of ruinous competition, through its restrictions on price cutting. If, by this means, it reduces business mortality, it accomplishes something of economic benefit. If, on the other hand, it retains in trade inefficient and high-cost distributors, or attracts additional units of the same character, it is merely providing a subsidy for uneconomic concerns. By ameliorating, however, one of the severest aspects of the competitive struggle, resale price maintenance lays a foundation for the continued functioning of many desired retail units and reduces the death rate in the retail fields to which it is applicable. Where strenuous competition is forcing a wide area of profit margins to subnormal levels, it is to the interest of the general economy that organized effort be taken to remove the destructive features.

"Loss leader" selling is neither as innocuous as its practitioners testify nor as dangerous as its enemies charge. To discuss it adequately would involve one in a maze of accountancy and merchandising policies. If by "loss" is meant selling below invoice cost, it is obvious that it has no economic justification other than advertising. If the article is sold at a price that does not carry a full share of operating expenses, its increased sales may warrant the practice. If the price of the article sold does not include a proportion of those various factors called "overhead," the confusion as to the economic or business propriety of the practice becomes almost unsolvable.

It seems undeniable, however, that positive evils may be found in connection with the worst features of this method of selling. "Loss leader" prices do not change with supply and demand, but are announced or withdrawn according to the whim or business judgment of the seller. They are as definitely "administered" prices as are the prices whose maintenance is often attempted. Because of frequent changes in the selection of leaders, and of the prices that will be asked, "loss leader" tactics remove any possibility of stable marketing of the

leaders actually utilized at any given time and also of all other articles that have potentialities as leaders.

Some merit, moreover, is to be found in the contention that oscillating and subnormal prices for trade-marked goods affect unfavorably the goodwill that has been created by manufacturers' advertising. Goodwill is an evanescent asset that may be quickly blown away. The destruction of established prices may readily demolish faith in quality.

Probably the strongest attacks against "loss-leader" selling have utilized the argument that it deceives consumers. Unquestionably this contention has been exaggerated, but average consumers are a credulous lot, and a false impression that a few outstanding low prices are reflected in the whole price policy of the store is easy of acceptance.

Since the only function of "loss-leader" selling is to act as "bait" for the sale of other articles, the gullibility of consumers perhaps creates the need for some outside protection. The "loss leader," as a device to attract customers, is not in quite the same category as advertising.

This list of reasonable arguments for resale-price maintenance is neither long nor formidable. It does not in the least prove a justification for such legislative devices as have been adopted, but it does show a need for the creation of some methodology for curing a few weaknesses of marketing that are beyond the control of individual concerns. A search should be made for substitutes for the defective methods that now exist.

ARGUMENTS AGAINST RESALE-PRICE MAINTENANCE

It would be desirable to classify the opposition arguments in such a way as to show the adverse effects of price control upon the various groups concerned. Such a procedure is impracticable, however, because the effects are so generalized and so interrelated that their incidence on any particular segment of the industrial structure cannot be isolated. An attempt will be made to put into juxtaposition those arguments that are most closely related to each other, but no clear-cut separation by definite boundaries can be achieved.

The effects of resale-price maintenance on consumers can be most successfully segregated. Here theory is supported by facts. It is argued that price control would have no reason for existence if it did not result in higher prices, and the facts bear out the argument. Convincing figures are, however, entirely inadequate, and we must await broader studies than have yet been made for confirmation of the early reports. A few of these figures may be cited.

> (1) In California cut-rate and chain-store institutions, in metropolitan centers, prices of maintained items were raised, on the average, one-third above the prices for the same articles before the law was made effective.
>
> "There can be no doubt that resale-price maintenance * * * has made for higher prices on advertised products * * *"[8] In small outlying districts there was no increase (in some places there was a slight decrease) because prices had not been cut previously.

[8] E. T. Grether: "Experience in California With Fair Trade Legislation Restricting Price Cutting," California Law Review, vol. 24, p. 676. September 1936. This article of 60 pages is one of the best availalbe on actual experience with the law.

(2) In a Los Angeles cut-rate store, in October 1938, prices of five very popular nationally advertised drug items were 135 percent higher than prices of their identical substitutes. Increases after the passage of the California act ranged up to 29 percent and decreases to 7 percent, according to type of store and size of city.[9]

(3) In comparing Washington, where there is no price-maintenance law, with Baltimore, where such a law exists, it was found that for 55 identical items, under contractual prices in Maryland, prices were the same for about one-half of the items. More than one-third of the Washington prices were lower and only one-tenth were higher than in Baltimore.[10]

Such figures as are available show almost universally that price-maintained items sell for higher prices than nonmaintained goods; that prices of contractual articles rose after the law was passed; that prices average higher in cities where maintenance is legal than in comparable cities where it is not legal. The National Association of Retail Druggists has made much of the fact that prices in some outlying stores and in some small towns showed a slight decline after the passage of the law. The agreement is not convincing, however, because of—

(*a*) The meagerness of the decreases where they have been found.

(*b*) The fact that these prices were always high prices.

(*c*) The much more than offsetting increases in the large stores and cities.

(*d*) The fact that most of the figures have been compiled by the drug association itself.

There is ample justification for the broad conclusion of Grether, the best authority, that resale-price maintenance means high prices and increased prices.

By indirect means also there is a tendency to mulct consumers. Prices cannot be set and maintained unless the articles are readily identifiable and the demand for them is continuously nursed and kept alive. This means that manufacturers must make a great outlay for advertising and, of course, the only source of these funds is the consumer. Advertising, then, that is wasteful in that it only persuades people to buy one brand instead of another, and that is expensive on any account, builds up a quasi-monopolistic position for producers and makes consumers pay for it. It is encouraged and aided by resale-price-maintenance practices.

Advertising, moreover, may be wasteful in another sense—that it tends to persuade people that branded, advertised, and high-priced goods are the best. This may, at times, be true, but consumers' organizations have accumulated enough evidence to suggest that it is far from universal. Since the control of resale prices is stimulative of additional advertising, it is, therefore, of assistance in the deception of consumers, as well as in the enhancement of the imperfections of competition.

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[9] Ralph Cassady, Jr.: "Maintenance of Resale Prices by Manufacturers," Quarterly Journal of Economics, vol. 53, No. 3, p. 456–7. (May 1939.)

[10] Mrs. Eugene Callaghan: Hearing before a subcommittee of the Committee on the District of Columbia, U. S. Senate, 76th Cong., 1st sess., on H. R. 3838, Fair Trade Act. (This testimony contains much original factual material.)

Under the contemporary system of one-price merchandising the consumer has little chance to do any bargaining and higgling; he expects the retail merchants to do this for him and to secure the best prices obtainable. Under resale-price maintenance the retailers abandon this function for a considerable number of articles, and the consumer is left completely at the mercy of administered prices or a choice of substitutes.

It is reasonable that other adverse effects will appear, especially as they relate to consumers with most limited purchasing power. Under resale-price-maintenance contracts, prices of contractual goods can vary little or not at all from store to store, regardless of location or of services rendered. A cash-and-carry store in a poor neighborhood must ask as much for the article as the Park Avenue shop with attractive and expensive furnishings, numerous and courteous clerks, charge-account privileges, and delivery service. The poor who cannot or do not want to pay for expensive services must do so whether they get them or not.

Still more remote from consumers, but yet affecting them, is the tendency of resale-price control to develop a stand-still condition in the marketing structure. The search for profits has created, within a relatively few years, a host of new selling types, such as chain-stores, mail-order houses, low-price department stores, cut-rate independents, supermarkets, and others. Their principal appeal to customers has been low prices. But under price-maintenance laws they have met restrictions that destroy the low-price appeal as applied to an ever-growing number of items, and discourage the entire low-price policy. This tends to freeze distribution *in statu quo*. It protects the inefficient, the unprogressive, and those who have abandoned the hazardous struggle for profits in a preference for security, while it penalizes the ambitious and resourceful merchants. It thus safeguards the living of one group, but reduces the opportunities for the more progressive, and at the same time takes away from consumers the advantages of low prices.

Closely related to the above tendency is the encouragement of uneconomic new competition. At present this would apply mainly to the drug trade, but enthusiasts for price maintenance in many lines are trying to extend its application. If dealers are to be guaranteed generous margins on a considerable part of the goods they sell, their position is going to look exceptionally attractive to a large number of potential competitors, most of whom would be of the type who do not succeed where profits are to be obtained only by efficiency and hard work. Such a process would add to the number of sellers without increasing the number of buyers and would, of course, eventually increase the number of bankruptcies. Unit margins may be assured by law, but there is as yet no guaranty as to the number of units that will be sold per store.

Most of the foregoing arguments against resale price maintenance are merely different aspects of the broader consideration that such a policy reduces or abolishes price competition among distributors. Events have proved that sales can be made with little or no price competition, but events have also proved that high prices reduce sales and output. Maintained prices are usually high prices. While the laws are not at present applicable to a sufficiently wide range of commodities as to affect the general economy appreciably, the process

is nevertheless in operation. If consumers buy as many articles at high prices as they did at lower prices the output of these goods is not affected, but the production of other goods will be reduced because consumers will have less money to spend for them.

Moreover, if price competition does not exist, or prices are established by contract, there can be no flexibility of prices. Supply is determined by an artificially determined demand which itself is, in fact, a function of an administered price. There is created a rigid structure of prices that does not yield either to general or specific changes in economic conditions. Thus is removed one of the factors most essential to adjustments to economic change. Production and employment are bound to suffer from this defect during declines in price levels or in periods of economic stagnation.

Since all of the fair trade laws legalize price maintenance contracts only for goods which are "in fair and open competition with commodities of the same general class produced by others," the friends of the policy argue that it is only a vertical arrangement for the disposal of goods and carries no implication of horizontal price fixing or absence of competition. The argument seems to be weak, and on two accounts. First, in the industries that utilize the price-fixing privilege, manufacturers will tend to regard the established price as permanent and will expect their rivals so to regard it. Any downward digression from the fixed price would be opposed by retailers and would be likely to be met by similar action on the part of competitors. Therefore no price cut will be made. Such a situation may arise without any price-maintenance laws, or without collusion among the manufacturers, but it is aided and supported by such laws.

In the second place, pressure from distributors creates a strong resemblance to horizontal price fixing. The druggists, through their State and National associations, decided that they needed a 50 percent mark-up on invoice prices. This comes close to horizontal action, although it is taken through the medium of an association. Moreover, such pressure exerted simultaneously on competing manufacturers reinforces the tendency toward identical prices at the production level. Horizontal price fixing may not exist in name, but it is closely approached in fact.

And finally, no adequate definition for "free and open competition" exists. No trade-marked and advertised article can be in completely free competition with any other article, yet this is the only type of goods to which resale price maintenance is applicable. The courts will ultimately have to decide some fine-spun questions of economic theory.

In summary, it is sufficient to point out that resale price maintenance is not a fair-trade measure but a price-fixing, margin-setting measure that injures consumers, reduces flexibility of output, restricts progress in marketing, and contributes to monopolistic prices and monopolistic action.

RESALE PRICE MAINTENANCE LAWS IN THE UNITED STATES

It is impossible to discuss in detail the various State laws, but since they all closely resemble the California law (first passed in 1931 and amended in 1933), and in many cases are identical with it, a brief examination of that act will be sufficient.

California Fair Trade Law

An act to protect trade-mark owners, distributors, and the public against injurious and uneconomic practices in the distribution of articles of standard quality under a distinguished trade-mark, brand, or name

The people of the State of California do enact as follows:

SECTION I. (a) No contract relating to the sale or resale of a commodity which bears, or the label or content of which bears, the trade-mark, brand, or name of the producer or owner of such commodity and which is in fair and open competition with commodities of the same general class produced by others shall be deemed in violation of any law of the State of California by reason of any of the following provisions which may be contained in such contract:

1. That the buyer will not resell such commodity except at the price stipulated by the vendor.

2. That the vendee or producer require in delivery to whom he may resell such commodity to agree that he will not, in turn, resell except at the price stipulated by such vendor or by such vendee.

(b) Such provisions in any contract shall be deemed to contain or imply conditions that such commodity may be resold without reference to such agreement in the following cases:

1. In closing out the owners' stock for the purposes of discontinuing delivering any such commodity.

2. When the goods are damaged or deteriorated in quality, and notice is given to the public thereof.

3. By any officer acting under the orders of any court.

SEC. 1½. Willfully and knowingly advertising, offering for sale, or selling any commodity at less than the price stipulated in any contract entered into pursuant to the provision of section 1 of this act, whether the person so advertising, offering for sale, or selling is or is not a party to such contract, is unfair competition and is actionable at the suit of any person damaged thereby. (This section added by amendment in 1933.)

SEC. 2. This act shall not apply to any contract or agreement between producers or between wholesalers or between retailers as to sale or resale prices.

SEC. 3. The following terms, as used in this act, are hereby defined as follows: "Producer" means grower, baker, maker, manufacturer, or publisher. "Commodity" means any subject of commerce.

SEC. 4. If any provision of this act is declared unconstitutional it is the intent of the Legislature that the remaining portions thereof shall not be affected but that such remaining portions remain in full force and effect.

SEC. 5. This act may be known and cited as the Fair Trade Act. (Approved 1931.)

Section 1 (a) legalizes the making of a contract relating to the sale or resale of a branded or named commodity that is in free and open competition with commodities of the same general class made by others. Then follows a stipulation of the provisions that are made legal. (1) That the buyer will not resell except at the price stipulated by the seller. (2) That the buyer require of anyone to whom he sells that he will not, in turn, sell except at such stipulated price.

Section 1 (b) exempts from these price stipulations goods whose sale is being discontinued by the dealer; damaged or deteriorated goods, when public notice is given; goods being sold by a court order.

Section 1½ (added by amendment in 1933), denominates as unfair competition and makes actionable by any person damaged thereby, knowingly selling or offering for sale of any contractual article at less than the stipulated price, whether the seller is or is not a party to such contract.

Section 2 makes it clear that "horizontal" price contracts are not legalized by the act; the remaining sections need no comment.

The Federal act, popularly known as the Miller-Tydings Act (Public, No. 314, ch. 690, 75th Cong., 1st sess. (H. R. 7472)), is an amendment of the Sherman Antitrust Act, but, because of expected

Presidential disapproval, was passed as a part of the appropriations act for the District of Columbia, and approved on August 17, 1937. It may be regarded as an enabling act, to make effective the State laws that had been handicapped by their powerlessness to restrict interstate commerce. Employing, whenever practicable, the phraseology of the California act, it legalizes resale-price contracts in interstate commerce where such contracts are lawful in intrastate transactions in any State where the commodity is to be sold or shipped. It further provides that such contracts shall not be deemed unfair competition under the Federal Trade Commission Act, and then makes the exception of "horizontal" resale-price agreements.

At the present time 44 States have resale-price-maintenance laws, the remaining "free" States being Delaware, Missouri, Texas, and Vermont. In 1939 the Vermont Senate refused to enact such a statute. California, as has been mentioned, started the movement in 1931. After its amendment in 1933 that put teeth into the law, making it apply even to those who had not entered upon contracts; the other States rapidly fell into line. Nine acts were passed in 1935, five in 1936, and all but two of the remainder in 1937. Alabama and Mississippi were the latest to come in. The District of Columbia has held out up to now, but a bill has been introduced and hearings have been held in both Houses. It is still active, and will be pushed at the next session of Congress.

Slightly more than half of these laws closely follow the wording of the California act, while most of the remainder are based on the "model" N. A. R. D. draft. Only Wisconsin, among the early States, departs materially from the California type, and then only in that it adds a provision empowering [11] the State department of agriculture and markets to declare a resale-price-maintenance contract unlawful if the minimum resale price is found to be "unfair and unreasonable," after a complaint and hearing.

The newer laws, following the N. A. R. D. model, besides adding much precision to the wording throughout, have introduced several provisions to assure greater effectiveness.[12] These laws—

1. Give recognition to the right of the seller to refuse to sell not only to price cutters but also to those who deal with price cutters.
2. Permit contracts specifically binding the seller to exercise his right to refuse to sell.
3. Prohibit any but the owner of a trade-mark or his agents from initiating resale price contracts. (Based on Supreme Court decision protecting goodwill of owner of trade-mark.)[13]
4. Permit price cutting if identifying marks are removed. (Same court opinion.)

In 1936 the Supreme Court of the United States ruled the Illinois fair trade act constitutional [14] but there has been no final ruling on the provision of the newer laws that impose the contract price upon noncontractors. There remains, of course, much litigation before all of the details of the acts are finally interpreted. In this memorandum there is no intention to go into the legal intricacies.

[11] Zorn and Feldman: "Business Under the New Price Laws" (New York, 1937), p. 290.
[12] Merrell and Kittelle: "Analysis of the State Fair Trade Laws," Dun's Review, October 1937; Zorn and Feldman, op. cit., pp. 297–314.
[13] *Old Dearborn Distributing Co.* v. *Seagram Distillers*, op. cit.
[14] Ibid.

These laws are not criminal laws and provide for no enforcement by public authorities. They merely remove resale price contracts from the categories of unfair competition and restraints of trade. Enforcement must lie in suits for damages by parties who believe themselves injured, and actual damages will often be difficult to prove.[15]

The proponents of price-control laws have not been aggressive in bringing suits. They have, in the main, preferred to conduct "educational" campaigns directed primarily toward manufacturers and the general public, and to persuade uninterested retailers toward greater participation in the movement. This education has centered in the trade associations, who supplement it with strong pressure brought to bear on nonassenting manufacturers. Since individual dealers and manufacturers have been slow to resort to the courts, inconspicuous violators of the law often enjoy a considerable degree of immunity.

Some of the State "unfair practices" acts (e. g., California) provide that any trade association may maintain an action to enjoin acts of violators or to recover damages if injured by the violations. If such a provision should be applied to the "fair trade" acts, violations would unquestionably be more dangerous and prosecution more effective.

DIFFICULTIES AND LIMITATIONS ENCOUNTERED IN THE PRACTICE OF PRICE MAINTENANCE

If the dangers of price cutting have often been exaggerated the dangers to the economy of price maintenance have been likewise overemphasized. So many weaknesses and limitations exist that no profound social evil can be envisioned.

1. Price control is applicable to only a limited number of commodities.[16]

> They must be marked, standardized, and easily identifiable; otherwise there is no basis for customer choice.
>
> They must have a general appeal. Other goods would not justify price control.
>
> They must be neither expensive nor inexpensive. Customers of ordinary means seeking expensive goods will be inclined to much shopping and bargaining; well-to-do customers will pay high prices without maintenance laws. Price control is not necessary for inexpensive goods, for they are unlikely to be cut in price under any circumstances.

Perhaps 50 percent of all goods sold at retail are identifiable, but many of these do not carry the other qualifications. Moreover, many brands are not aggressively promoted, many manufacturers are not interested in price maintenance, and trade associations cannot adequately police the field. It is probable that not over 15 percent of retail sales come within the scope of the act.[17] And finally, many of the maintained prices are little or no higher than they would be without maintenance. It is impossible to estimate how much price-control practices have substracted from the purchasing power of consumers,

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[15] *Gueralain, Inc.*, v. *F. W. Woolworth Co.*, New York Supreme Court. New York Times, Aug. 8, 1939.

[16] Seligman and Love: Price Cutting and Price Maintenance, (New York, 1932) p. 154.

[17] Cassady; op. cit., p. 455. Professor McLaughlin of the Marketing Laws Survey suggests 10 percent as a probable figure.

but a small percentage of 15 percent of sales is not especially alarming. The acts have been applied with real effectiveness only to liquors, books, drugs, and cosmetics, although examples can be found in a great many other lines.

2. The laws themselves are weak in that they are permissive rather than mandatory, are in about half of the cases poorly and loosely worded and rely for their enforcement upon the voluntary actions of usually hesitant individuals. Neither public prosecution nor enforcement agencies or commissions are provided. And further, they will probably meet with strict interpretation by the courts.

3. The attitude of consumers is still largely a matter of guesswork. We know that most consumers are price-conscious, but to what extent this factor will overcome convenience, custom, and the pressure of advertisers cannot be estimated.

Organizations of consumers and many individuals are carrying on an effective campaign to educate consumers in greater buying knowledge and skill. It may be possible that greater resistance to the blandishments of advertisers will result.

The publicity undertaken in connection with price-maintenance laws and anti-chain-store laws may have effects the opposite of those intended. If consumers once become conscious that prices of certain articles are artificially held up by various laws they may decide to choose other articles and other sellers, or even overturn the laws. The relative small proportion of purchases that come under these laws may, however, nullify the possibilities just suggested.

4. The situations in the distributing trades are not conducive of too much optimism among price maintainers. Wholesalers are for the laws, but their influence and numbers are not great. Many retailers are either ignorant or apathetic or both.[18] Cut-rate stores and the large low-price department stores are in opposition. There are no legalized means of forcing contracts upon unwilling manufacturers. All price-maintaining distributors must compete with all the methods of avoidance, or even of evasion, devised by resourceful price cutters. That the lot of distributors is not, in this connection, a too happy one is suggested by the continued campaigns of the trade associations and their journals.

5. The manufacturers are in an anomalous position. They are subjected to the terrific pressure, sometimes amounting to coercion [19] that is exerted by distributors, and also subscribe, in general, to the product-differentiation argument, yet they can feel no assurance that the policy is correct.

In many cases they can have no doubt that higher prices to consumers reduce sales. This means a lower rate of output and increased unit costs. Price cutters have little interest in controlled items, will not push them and hence will buy less of them. Price cutters will also attract to their stores customers who will purchase substitutes for the price-maintained goods, which might otherwise have been bought in other stores.

Price-maintaining manufacturers must always fear price cutting by their competitors. This may not often occur in drugs and related lines, but it is not an impossibility anywhere. If they sell directly to mass retail distributors they must cope with requirements of wholesalers, who demand lower prices than those given to the large retail

[18] Grether; op. cit., p. 653.
[19] Cassady; op. cit., p. 461.

outlets. The problems of manufacturers are numerous and large, and they cannot be relied upon to give enthusiastic support to price-maintenance laws.

6. Price-cutting retailers have so many effective devices for carrying on their particular methods of merchandising that they can often successfully avoid the control laws. They must maintain the minimum price for contractual goods, but they are not compelled to give emphasis to those goods.

Private brands are growing in popularity as alternatives to maintained goods. Large distributors can feature their own brands with much success, maintain their low-price policy and yet secure their normal profit margins. A comparison with price-maintained articles can be made so effective that price-conscious consumers will abandon their preferences for certain brands without too much difficulty.

One of the typical tools of price-cutting institutions is the loss-leader. It is not essential, however, that these leaders be price-maintained articles. Special drives, displays, salesmanship may be utilized to attract customers, and the result be a deemphasis of goods with controlled prices.

The same principles may be employed without resort to loss-leader selling. Noncontract items and lines are pushed; contract articles are kept in the background; comparisons unfavorable to the contractual goods are made.

Discounts, special deals, gifts, bonuses, premiums, coupons, bargain combinations—a bewildering group of offerings—are all available to the low-price opponents of resale price maintenance. That they weaken the sales of maintained goods is evident.

In a more general sense resale price maintenance is weak in its ability to contribute to the permanent prosperity of distributors. And perhaps its broader defects will, in the long run, be of greater significance than its deficiencies of detail.

Potential new competition has been previously mentioned, but deserves reemphasis. The farther price maintenance spreads over the field of distribution, the more complete its guaranty of resale margins, the greater will be the inducement to increasing the number of outlets. Many individuals will see a chance, free from the dangers of price competition, to seize a share of a relatively stable market, and will establish additional units. Resale margins will remain high, but unit sales per outlet will decline and profits per store will go down with them. The excessive multiplicity of gasoline filling stations furnishes a good example. Stability of prices and margins is no guaranty of adequacy or stability of incomes in distributive lines where entrance of newcomers is easy.

Fixed prices may be delightful for producers and dealers when the general price level is steady, but in a period of a rising price level the situation is not such a happy one. Purchasers who have been educated by all the devices of merchandising to expect a certain price for their favorite articles will regard higher prices with considerable irritation and may turn to goods to which no customary price has been attached. These latter articles may move upward with no questions asked and their vendors may readily adapt prices to changing situations. It is not so with the fixed-price sellers. Again it may be remarked that a guaranty of margins is not a guaranty of sales.

Most important of all are the adverse effects of a rigid price structure upon the whole economy. Prices that cannot adjust themselves to changing economic conditions are prices that result in decline of sales, underproduction, higher costs, unemployment, cumulative loss of purchasing power, progressive stagnation. Resale price maintenance may be no great menace when all other economic conditions are favorable, but it may be an exceedingly disruptive element during economic disorder and prove to be a boomerang for its sponsors as well as a danger to society.

INTERRELATIONSHIP WITH OTHER FACTORS

To discuss resale price maintenance in isolation from other factors of economic and social life is superficial. Interrelationships are numerous and significant. Certain factors reinforce price control, while others weaken it.

1. Relationship with other factors that reduce price competition.

(*a*) *"Unfair practices" laws.*—These are otherwise variously denominated as loss-leader laws, no-sale-below-cost laws, minimum mark-up laws. The general intent is to apply to all commodities restrictions similar to those applied to identifiable goods by the price-maintenance laws. Such laws now exist in 16 States, but what particular type will finally receive the general support of price-controlling interests is not yet clear. Four types of limitations on selling price have been suggested: The invoice cost of the goods, a specified 6 to 10 percent above invoice cost, invoice cost plus a proper share of operating expenses, and invoice cost plus a proper share; all costs, including "overhead," are enumerated.

(*b*) *Laws such as the Robinson-Patman Act that prohibit a seller from discriminating as to price among his various customers who buy for resale.*—This Federal law meets its State counterpart in a section of the California "unfair practices" act.

(*c*) *Chain-store tax discrimination laws.*—As yet these laws are confined to the States and carry various degrees of injurious possibilities. Efforts to enact similar Federal legislation have not, however, been abandoned.

It is clear that with all these varieties of laws in existence distributors who prefer to make their profits by means of a low price are meeting with tremendous difficulties. And the combination of restrictions that is likely to create a rigid structure of high prices is offering a real menace to the economy. Resale price-maintenance laws are not understandable without reference to these other limitations.

2. Relationship with outside fields.

Although the relationships are less distinct, the effectiveness of resale price-maintenance laws will depend much upon various other developments.

(*a*) Such laws may stimulate the growth of consumers' cooperatives which, in turn, would reduce the strength of the price-maintenance laws.

(*b*) The spirit of the antitrust laws is violated by price-control laws. A clearer solution of the conflict is imperative.

(*c*) Growth of consumer education and protection may diminish greatly the effectiveness of advertising and the potency of brands. The demand for high quality and low price will flourish.

(*d*) If concentration of production continues to grow the problem of price maintenance will diminish. The producers will take care of that.

CONCLUSIONS

1. Resale price maintenance is bad in principle and practice. It sets a bad precedent and has possibilities for extrusion. It injures consumers, penalizes progress, and introduces an unhealthy element of rigidity into the price structure.

2. Resale price maintenance is not, at present and in itself, a major economic evil. Despite its potentialities for evil the actualities are minor. It is applicable to only a small segment of trade, is surrounded by indifference and opposition, and is shot through with possibilities of evasion and avoidance.

3. The extension of resale price maintenance should, therefore, be opposed. Where possible, it should be repealed or allowed to become a dead letter.

PART III

ADEQUATE LONG-TERM AND SHORT-TERM FINANCING

262652—41—No. 17——15

CHAPTER XVII

CAPITAL AND CREDIT PROBLEMS OF SMALL BUSINESS[1]

THE FINANCIAL POSITION OF SMALL BUSINESS

Available evidence indicates that the financial position of small business has been weakened since 1929. Most of the data used in the following section refer to corporations submitting balance sheets to the Bureau of Internal Revenue. They cover the 6-year period 1931–36. This is the only evidence which permits of comparison by size of business enterprise. There is some question as to whether generalizations from a sample consisting only of corporate enterprise can be applied to noncorporate enterprise. Large business enterprise, however, is practically all in corporate form. Hence, the sample for large business enterprises may be taken to be identical with the universe of large business enterprises. This is not the case with the small-business universe. Most small businesses are individually owned, or are partnerships. Since the corporate segment of small-business enterprise is larger and stronger, on the whole, than noncorporate small business, it is reasonable to infer that the severe effect of the depression on corporate small business fell at least equally as severely upon noncorporate small businesses. Our comparison of the relative financial and commercial position of large and small businesses in terms of the corporate segments of each is therefore valid also for large and small business as a whole. If anything, we may infer that small unincorporated businesses were relatively worse off than the data based on corporate business indicate.

Prior to 1934, the data were based on consolidated returns, where there were interrelated groups of corporations. For the period 1934–36, the analysis pertains only to the individual members of such corporate systems as existed. From the point of view of the corporations, the advantage of the consolidated return lay in the fact that losses of one subsidiary could be offset against profits of another; in this way, the taxable income of the whole group was reduced. This difficulty is of some significance in dealing with profits rates by years, since comparability is affected, however, average rates for the period 1931–36 as a whole remain valid for analysis by size groups. Another question raised by the elimination of consolidated returns has to do with the homogeneity of industrial classifications; since most of the data presented deal with broad groupings, this difficulty is likewise largely eliminated.

There remains one problem of indeterminate significance arising from the change in the law. Aggregate figures for pairs of items such as receivables and payables, surplus and deficit, gross sales and cost of goods sold, were changed in magnitude to a varying degree, as off-

[1] Prepared by William B. Saunders, Harold Vatter, and Harold H. Wein, Industrial Economics Division, Department of Commerce.

setting factors between affiliated corporations of a consolidated system were removed. The probability that percentage changes in the various items were equal is relatively small; this will have some effect on the comparability of the ratios used in this study. Thus, equity figures in a consolidated return may be relatively small compared to what they would be if regarded separately, whereas assets may be relatively unchanged in the two forms; consequently, the ratios of equity to assets in 2 years may not be strictly comparable.

One of the key factors in carrying on business is adequate working capital—that is, availability of assets of the type that enter into the day-to-day transactions and maintain the continuity of operations. The following table, compiled by Donald Woodward of Moody's Investors Service, presents data for manufacturing industries, based on reports to the Bureau of Internal Revenue. The "large corporations" are 316 in number, specially tabulated by Moody's with assets ranging upward from $3,000,000. The working capital for the smaller corporations is the difference between the total working capital of all manufacturing corporations submitting balance sheets (which include the 316 large companies) and the 316 large corporations.

TABLE 1.—*Aggregate volume of working capital in manufacturing industries*

Year	Manufacturing corporations submitting balance sheets	Large corporations	Small corporations	Proportion of large companies' share to total	Index: 1929=100	
					Large corporations	Small corporations
1926	$18,985,000,000	6,696	12,289	35.3	83.3	97.9
1927	19,042,000,000	6,859	12,183	36.0	85.3	97.1
1928	20,142,000,000	7,450	12,692	37.0	92.7	101.1
1929	20,588,000,000	8,037	12,551	39.0	100.0	100.0
1930	18,794,000,000	7,618	11,176	40.5	94.8	89.0
1931	16,010,000,000	6,916	9,094	43.2	86.1	72.5
1932	13,562,000,000	6,021	7,541	44.4	74.9	60.1
1933	14,192,000,000	6,132	8,060	43.2	76.3	64.2
1934	13,641,000,000	6,187	7,454	45.4	77.0	59.4
1935	14,086,000,000	6,502	7,584	46.2	80.9	60.4
1936	15,138,000,000	6,793	8,345	44.9	84.5	66.5
1937		7,002			87.1	
1938		7,356			91.5	

Source: Hearings on Mead bill (S. 1482 and S. 2343), 76th Cong., 1st Sess.

The table shows a significant trend toward concentration of working capital in the 316 large corporations. Their proportion of the total rose almost without interruption from 1926 to 1936, increasing from 35 to 45 percent of the total volume of working capital owned by manufacturing corporations. This trend may best be interpreted as showing one aspect of the increasing financial strength of the large corporations relative to the smaller businesses.

The effect of the depression was particularly severe on the smaller companies. Their volume of working capital declined more sharply during the depression years and recovered only slightly. The smaller corporations had lost 40 percent of their working capital by 1932 and by 1936 had regained only 7 percent; in the same period the large corporations lost 25 percent and regained 10 percent.

Inadequate working capital is often defined in terms of a low ratio of current assets to current liabilities. The current ratio shows how much can be currently realized from the sale of merchandise and the collection of receivables for every dollar that must be paid out cur-

rently in meeting short-term obligations. A ratio of 2.0 is a rule-of-thumb measure of soundness, since there would be sufficient funds available to meet current obligations even if the current assets should shrink to one-half their stated value or be converted into cash half as rapidly as was anticipated.

If we examine the working-capital ratios of corporations submitting balance sheets to the Bureau of Internal Revenue and classify them according to size of assets, we find the working-capital ratios increasing with the size of the corporations as shown in the following table:

TABLE 2.—*Current ratios for corporations in all manufacturing combined, in manufacturing textiles and their products, and in trade, 1932 and 1936*

Asset class	All manufacturing		Textiles and products		Trade	
	1932	1936	1932	1936	1932	1936
0 to $50,000	1.36	1.43	1.71	1.74	1.81	1.78
$50,000 to $100,000	1.73	1.82	2.14	1.93	2.34	2.14
$100,000 to $250,000	1.95	2.08	1.96	2.04	2.44	2.17
$250,000 to $500,000	2.36	2.40	2.30	2.28	2.70	2.41
$500,000 to $1,000,000	2.68	2.54	2.76	2.79	2.80	2.35
$1,000,000 to $5,000,000	3.11	3.16	3.26	3.32	3.03	2.28
$5,000,000 to $10,000,000	3.94	3.58	4.56	3.12	2.87	2.07
$10,000,000 to $50,000,000	3.83	3.65	5.84	4.60	2.42	2.02
$50,000,000 and over	3.54	3.12		4.82	2.13	2.10

Source: Statistics of Income.

Short- and Long-term Debt.

Another indication of the greater financial strength of large businesses is seen in the structure of their financing. On the whole, the larger corporations get a larger proportion of their capital from stockholders and a smaller proportion from lenders than do the smaller corporations. Borrowed capital must eventually be repaid; it carries interest charges which must be met as a cost of doing business. Stockholders' (equity) capital is a permanent investment, and dividends are contingent upon earnings. The larger corporations that borrow money have, as a rule, fixed maturity dates, with a smaller proportion of their borrowed money at the call of creditors.

The following table shows the ratio of current liabilities to total borrowed capital, by size of corporation.

TABLE 3.—*Ratio of current liabilities to total borrowed capital for corporations in all manufacturing, in manufacturing textiles and their products, and in trade, 1932 and 1936*

[All ratios in percent]

Asset class	All manufacturing		Textiles and products		Trade	
	1932	1936	1932	1936	1932	1936
0 to $50,000	86	77	93	91	91	90
$50,000 to $100,000	80	81	88	90	84	81
$100,000 to $250,000	77	79	84	88	79	84
$250,000 to $500,000	71	75	78	84	77	83
$500,000 to $1,000,000	69	73	75	80	75	83
$1,000,000 to $5,000,000	58	68	72	76	69	81
$5,000,000 to $10,000,000	44	50	53	76	69	85
$10,000,000 to $50,000,000	43	56	52	76	56	78
$50,000,000 and over	42	55		81	68	91

Source: Statistics of Income.

The table shows that the smaller companies finance themselves largely on a short-term basis, whereas the larger corporations rely on long-term funds. Thus, in manufacturing as a whole, about 80 percent of the borrowed capital of the smallest corporations is subject to the call of creditors. This percentage declines with each larger class until, in the largest class (with assets of $50,000,000 or more), only about 50 percent of the borrowed capital is callable. The vulnerability of the small corporations, especially in the downswing of the cycle when credit is becoming tight, is readily apparent. The creditor can call the debt when his own position requires it. Thus, the small businessman is weakest in a cyclical decline, not only because his own market is shrinking, but because his creditors' position is likely to be weak. The large firm with a preponderance of long-term debt must meet only the interest burden, whereas the small firm has both interest and principal to pay off.

The high proportion of current liabilities is a partial explanation of the low current ratios characteristic of small business. If the debt structure of all corporations were uniform, the current ratios would not show such great variation.

Present Equity.

The value of the owners' share in the business is an important measure of financial strength. This "equity" in the case of corporations, is the value of preferred and common stock, plus surplus and undivided profits, minus the deficit. There is a considerable possibility of error in the data arising from the "book value" of stocks, which may be altered without affecting assets directly. With this potential defect in mind, we may examine the following table.

TABLE 4.—*Ratio of equity to total assets for all manufacturing corporations, 1932 and 1936*

[All ratios in percent]

Assets	Returns with net income		Returns with no net income	
	1932	1936	1932	1936
0 to $50,000	67.5	58.1	49.2	33.8
$50,000 to $100,000	72.4	64.0	60.2	45.8
$100,000 to $250,000	77.1	67.4	65.3	51.4
$250,000 to $500,000	80.0	71.0	70.3	54.2
$500,000 to $1,000,000	82.4	73.2	73.6	53.6
$1,000,000 to $5,000,000	83.5	75.6	75.9	57.3
$5,000,000 to $10,000,000	84.6	74.0	73.6	58.2
$10,000,000 to $50,000,000	81.5	75.6	75.0	53.1
$50,000,000 and over	79.4	77.0	71.4	42.0

Source: Statistics of Income.

It is evident that the ratio of equity to total assets, in general, varies directly with the size of the corporation. This relationship applies to individual industries as well as to the group for which data are presented. For every dollar of assets, the small firm has a smaller proportion of invested capital than the large firm. This suggests either that the large company has been more profitable and has thereby increased its equity or that it has freer access to the capital market than does the small company. In either case, it is clear that the small firm is relatively vulnerable because of the higher proportion of borrowed funds in its financial structure.

By 1936, the equity status of all groups had been weakened. Moreover, the decline in the ratios is somewhat greater for the smaller corporations, especially those showing no net income. This is indicated in the following table.

TABLE 5.—*Percentage changes in equity ratios for manufacturing corporations*

Asset class	Percentage decrease in equity ratios, 1932–1936		Percentage by which ratio for income corporations exceeds ratio for deficit corporations	
	Income corporation	Deficit corporation	1932	1936
0 to $50,000	13.9	31.3	27.1	45.6
$50,000 to $100,000	11.6	23.9	16.9	39.7
$100,000 to $250,000	12.6	21.3	15.3	31.1
$250,000 to $500,000	11.2	22.9	12.1	31.0
$500,000 to $1,000,000	11.2	27.2	10.7	36.6
$1,000,000 to $5,000,000	9.5	24.5	9.1	31.9
$5,000,000 to $10,000,000	12.5	20.9	13.0	27.1
$10,000,000 to $50,000,000	7.2	29.2	8.0	42.4
$50,000,000 and over	3.0	41.2	10.1	83.3

Source: Statistics of Income.

Thus, for returns with net income, the ratio for the group with assets under $50,000 declined 14 percent between 1932 and 1936, while the largest class had a decrease of only 3 percent. For returns with no net income, the relationship is not as clear, especially because the largest group decreased so sharply. This difficulty arises frequently because of the relatively small number of firms in the class, causing undue weight to be attached to a few returns. It is clear, however, that the smallest corporations were in a relatively weaker position in 1936 than in 1932.

The table also indicates considerable weakening in the position of deficit corporations. In 1932, the ratio for the smallest net-income group was 27 percent above that for the deficit corporations in the same class; however, by 1936, those with net income had a ratio 46 percent higher than those which had no earnings. This relationship applies to corporations in all size groups. It is evident that the equity position of deficit corporations was much worse in 1936 than in 1932.

THE ECONOMIC POSITION OF SMALL BUSINESS

In 1935 there were, according to Dun & Bradstreet, 2,244,175 active firms in the United States. Arthur Whiteside, president of Dun & Bradstreet, estimates that 1,680,000 concerns have net worth under $120,000.[2] Excluding banks, insurance companies, and service concerns not seeking credit, 30 percent of all commercial units have an investment of $500 or less; 48 percent have between $500 and $10,000; 21 percent have more than $10,000. Although it is difficult to obtain adequate data as to the long-run trend in the number and size of firms, there is some evidence with respect to the short-run stability of enterprise.

[2] Temporary National Economic Committee Hearings, Part 9, "Savings and Investment," p. 3873 (76th Cong.).

In the field of retail trade, there are comparable data over a period of several years. According to the Census of Business, the number of retail stores was 1,543,158 in 1929 and 1,653,961, in 1935. Although this indicates relative stability of numbers, there is a large amount of turn-over in ownership.

In a study of Births and Deaths of Retail Stores in Indiana, 1929–37,[3] it was found that "out of a total of 10,430 stores in business at the end of 1929 and 13,585 starting during the next 8 years, disappearances aggregated 14,509 or 139 percent of the number of stores operating at the end of 1929. Since the actual number of closings exceeded openings by 924, there were 9 percent fewer retail outlets in 1937 than in 1929. * * *

"In general the lines with the smallest capital investment might be expected to have the highest turn-over, since the ease with which a person may enter an unregulated business is determined in large part by the capital necessary to start the business." About 54 percent of the disappearances were registered in the class with less than $2,000 in net worth; another 24 percent were in the $2,000 to $20,000 grouping.

These data refer to changes in ownership and management of retail outlets much more than with failures. In recent years, the number of failures has averaged between 10,000 and 12,000 per year.[4] Dun's Statistical Review classifies failures by volume of liabilities. In the accompanying table, it is evident that over 90 percent of the manufacturing concerns failing in the period 1935–39 had liabilities under $100,000. In wholesale trade, this proportion was about 97 percent and in retail trade about 99 percent. Moreover, in each group, at least three-fourths had liabilities under $25,000.

TABLE 6.—*Failures by industrial groups and size of liabilities*

Liabilities	Number of failures as percent of total in each group				
	1935	1936	1937	1938	1939
MANUFACTURING					
Under $5,000	25.0	28.0	21.4	22.0	22.8
$5,000 to $25,000	53.2	51.5	51.6	50.9	52.3
$25,000 to $100,000	16.3	16.3	17.5	20.1	18.2
Under $100,000	94.7	95.8	90.5	93.0	93.3
$100,000 and over	5.3	4.2	9.5	7.0	6.7
Total	100.0	100.0	100.0	100.0	100.0
WHOLESALE TRADE					
Under $5,000	26.4	24.7	23.2	23.4	26.1
$5,000 to $25,000	53.3	54.5	55.0	55.0	55.9
$25,000 to $100,000	16.8	17.5	19.4	18.4	15.6
Under $100,000	96.5	96.7	97.6	96.8	97.6
$100,000 and over	3.5	3.3	2.4	3.2	2.4
Total	100.0	100.0	100.0	100.0	100.0
RETAIL TRADE					
Under $5,000	51.8	51.1	52.0	48.7	49.8
$5,000 to $25,000	41.4	42.0	42.3	44.2	44.2
$25,000 to $100,000	5.9	6.2	5.2	6.5	5.6
Under $100,000	99.1	99.3	99.5	99.4	99.6
$100,000 and over	.9	.7	.5	.6	.4
Total	100.0	100.0	100.0	100.0	100.0

Source: Dun's Statistical Review, February 1937, 1939, 1940.

[3] Dun's Review, January 1940.
[4] See, for example, Dun's Statistical Review, February 1939.

Closer examination of the data[5] reveals that, for firms with liabilities under $100,000, the volume of current liabilities was identical with total liabilities. Apparently, the smaller firms had no long-term debt, as was the case with the larger companies. We have already seen that, for all corporations, current liabilities represent about 80 percent of total borrowed capital in the smallest asset class. Claims on the assets of small firms are thus composed almost entirely of current liabilities and the owners' investment. Inasmuch as the smaller corporation has a smaller proportion of equity to assets, the weakness of small business in economic fluctuations is apparent.

Net Income.

One of the most significant measures of the economic status of small business is relative profitability. The following table shows the relationship of the smallest corporations (assets of less than $50,000) to the total number of corporations filing balance sheets with the Bureau of Internal Revenue.

TABLE 7.—*Proportion of smallest corporations to total corporations, 1931–36*

Year	Proportion of income corporations with less than $50,000 assets to total income corporations	Proportion of deficit corporations with less than $50,000 assets to total deficit corporations	Proportion of corporations with less than $50,000 assets to total number of corporations
1931	45.79	49.13	47.88
1932	45.73	54.27	52.67
1933	46.95	57.09	54.45
1934	46.95	57.93	54.33
1935	45.54	60.21	54.80
1936	43.34	64.12	54.70

Source: Statistics of Income.

Although the relative number of corporations in the class with assets under $50,000 had increased 7 percent between 1931 and 1936, they formed a decreasing percentage of the profitable firms and a sharply increased proportion of the unprofitable companies. In 1931, these small concerns were 46 percent of the net-income corporations, but by 1936 they declined to 43 percent of the total, a drop of 3 percent. On the other hand, they represented 64 percent of the no-net-income corporations in 1936, an increase of 15 percent. In part, the shift may be attributed to changes in classification rules by the Treasury in 1936; nevertheless the general trend shown is probably valid.

The following table shows clearly the variation in the proportion of large and small firms showing no net income.

TABLE 8.—*Proportion of smallest and largest deficit corporations to total corporations in each group*

Year	Percent of deficit corporations to total corporations (less than $50,000 asset class)	Percent of deficit corporations to total corporations (over $1,000,000 asset class)	Year	Percent of deficit corporations to total corporations (less than $50,000 asset class)	Percent of deficit corporations to total corporations (over $1,000,000 asset class)
1931	64.06	64.38	1934	71.60	62.14
1932	83.77	76.35	1935	69.36	54.93
1933	77.60	69.65	1936	64.06	34.13

Source: Statistics of Income.

[5] Dun's Statistical Review, February 1939.

In 1931, 64 percent of the firms in both groups had no net income; in 1936, there were still 64 percent of the small firms in that category, as compared with only 34 percent of the large enterprises. Thus, from the point of view of numbers, the smallest group had failed to improve its relative position between 1931 and 1936—since only 36 percent had any net income; on the other hand, the group with assets over $1,000,000 had a large increase in the proportion of firms with net income.

Thus far we have been considering the net-income position of small firms in all types of business. That the relative position of small manufacturing concerns has suffered since 1932 is clear from the data in table 9.

Column (1) shows that the smallest manufacturing corporations with deficits have constituted an increasing proportion of total deficit corporations, although the total of corporations in this class (assets under $50,000) has remained about one-half of all corporations filing balance sheets. As business improved, the relative number of small corporations showing no net income decreased from 86.8 to 64.3 percent of the total in the group (column 3). However, this decrease was much less rapid than the decrease in the number of large businesses with no net income. As shown in column (4), only 61 percent of those in the large group ($50,000,000 or more) had no net income in 1932; by 1936, this percentage had declined to 11.2 percent.

TABLE 9.—*Relationship of smallest deficit corporation to total corporations with and without net income*

Year	Proportion of deficit corporations with assets under $50,000 to total deficit corporations (1)	Proportion of all corporations with assets under $50,000 to total corporations (2)	Proportion of deficit corporations to total corporations in class with assets under $50,000 (3)	Proportion of deficit corporations to total corporations in class with assets of $50,000,000 or more (4)
1932	52.4	49.8	86.8	60.7
1933	58.6	51.2	79.1	48.7
1934	60.0	50.9	72.2	43.0
1935	62.6	51.0	69.8	33.3
1936	67.4	50.4	64.3	11.2

Source: Statistics of Income.

Examination of the profit record of manufacturing concerns reveals a direct relationship between size and profits.

TABLE 10.—*Ratio of compiled net profit (after tax) to net worth (average equity), manufacturing industries*

[Average 1931-36]

Size of asset class:	*Ratio (percent)*
0 to $50,000	−17.2
$50,000 to $100,000	−5.2
$100,000 to $250,000	−2.4
$250,000 to $500,000	−.3
$500,000 to $1,000,000	.8
$1,000,000 to $5,000,000	1.6
$5,000,000 to $10,000,000	2.4
$10,000,000 to $50,000,000	2.5
$50,000,000 and over	3.6

Source: Statistics of Income.

Profitability varies with the size of business. The smallest size class shows the greatest loss, the largest size class shows the greatest profit. It is well to note that these ratios are based on combined returns. A more detailed break-down reveals that small manufacturing corporations showing net income tend to have higher ratios than the larger ones; at the same time, small no-net-income corporations have higher losses. In general, large corporations that make profits make them at lower rates than small ones, while large corporations that lose money, lose at lower rates than small ones. But, since so few small corporations show any earnings, the group average in the smaller classes will be dominated by the no-net-income corporations. Another fact of striking significance is that corporations with assets under $500,000 averaged deficits during the period 1931–36.

The observed correlation between size (as measured by assets) and profit rates in all manufacturing corporations is significant and not due to differences among the various branches of manufacturing industries. This is shown by the following table.

TABLE 11.—*Ratio of compiled net profit (after tax) to net worth (average equity) in three manufacturing industries*

[Average 1931-36]

Size of asset class	Food ratio[1]	Metals ratio	Textiles ratio
	Percent	*Percent*	*Percent*
0 to $50,000	−11.1	−19.2	−23.9
$50,000 to $100,000	−2.7	−5.9	−7.6
$100,000 to $250,000	−.8	−3.2	−3.7
$250,000 to $500,000	2.1	−1.6	−.7
$500,000 to $1,000,000	3.2	−.4	.0
$1,000,000 to $5,000,000	3.3	.3	.4
$5,000,000 to $10,000,000	4.0	.9	[2] .7
$10,000,000 to $50,000,000	[1] 6.2	.6	
$50,000,000 and over		3.2	

[1] Classes grouped $10,000,000 and over.
[2] Classes grouped $5,000,000 and over.

Source: Statistics of Income.

It can be seen that differences do exist between groups of manufacturing industries. The range of variation in the food group is much less than in metals or textiles. The yearly record shows that the food groups respond less sharply to cyclical influences than either metals or textiles and that the profit disparity between the lowest size group and the highest is much less in this branch of manufacturing than in any other.

Notwithstanding the differences in detail between these branches of manufacturing industry the basic correlation of profit rate and size is apparent in each branch. W. L. Crum, who has studied this question in great detail, concludes—

> The almost universal prevalence among the groups of a positive correlation between rate and size—a tendency for rate to increase as size increases—strengthens the conclusion that in manufacturing in general, this correlation is characteristic and fundamental. Whatever be the causes of the increase of rate with size, they are not to be found in the accidental mingling of widely different types of industry in the manufacturing division.[6]

The same correlation between size and profit rate has been shown to exist in all the branches of corporate industry.[7] It is not so defi-

[6] W. L. Crum, Corporate Size and Earning Power, Harvard University Press, 1939, p. 158.
[7] W. L. Crum: Ibid.

nitely established that differences in size are a significant factor in the explanation of differences in profit rate for these other segments of corporate industry as in the manufacturing segment.[8] Break-downs comparable to those which exist for manufacturing industry are not given, and so the possibility that the differences in profit rate are simply the result of the mingling of widely different branches with different typical profit rates is not conclusively eliminated. It is, however, extremely improbable that, in all the segments of corporate enterprise classified by the Bureau of Internal Revenue, the basic positive relationship of size and profit rate should appear were size not a significant factor.

The following table, which shows the profit rate and asset size of all corporations, may then be taken as the average pattern.

TABLE 12.—*Ratio of compiled net profit (after tax) to net worth (average equity), all corporations*

[Average, 1931–36]

Size of asset class:	Ratio (percent)
0 to $50,000	−16. 3
$50,000 to $100,000	−4. 7
$100,000 to $250,000	−2. 7
$250,000 to $500,000	−1. 4
$500,000 to $1,000,000	−. 8
$1,000,000 to $5,000,000	−. 1
$5,000,000 to $10,000,000	. 4
$10,000,000 to $50,000,000	1. 4
$50,000,000 and over	2. 6

Source: Statistics of Income.

We may conclude that in branches of industry sufficiently large to show wide size distributions, it is highly probable:

(*a*) There will be a significant positive variation of profit rate with size of firm.

(*b*) The profit rates for the largest firms will be significantly above the rates for the smallest firms.

Share of the Market.

The best available market data is to be found in the field of retail trade, which is overwhelmingly a "small business" industry. According to the Census of Business in 1935, the chains are the "big businesses" in retail trade though some independent local branch systems are also "big businesses." In 1935 there were 6,079 chains in retail trade operating 127,482 stores, while there were approximately 1,450,000 independents operating about 1,480,000 stores. The gross sales per chain in 1935 were $1,242,000. The gross sales per independent were approximately $16,750. However, the "smallness" of the great mass of retail storekeepers is not really shown by this latter figure, small though it is. Almost one-half of all independent retailers have gross sales of less than $5,000 per year. The independents have since 1929 lost part of the market to chains and other types of retail units. The independents' share of gross sales decreased by 4.4 percent, while the number of stores which they operated remained constant. The chains, on the other hand, increased their sales by 2.8 percent, while the number of stores operated by them decreased by 1.9 percent.

[8] The Bureau of Internal Revenue classifications are Manufacturing, Mining, Agriculture, Construction, Trade, Service, Public Utilities, Finance.

TABLE 13.—*Stores and sales by size of stores, 1935, independents, chains, and mail order*

Gross sales	Number of stores		Percent of total stores		Percent of total sales	
	Independent	Chain and mail order	Independent	Chain	Independent	Chain
Less than $1,000	177,151	926	11.6		0.4	
$1,000 to $1,999	173,720	1,254	11.4		1.0	
$2,000 to $2,999	127,293	1,381	8.3		1.2	
$3,000 to $4,999	201,835	2,824	13.2		3.2	
Less than $5,000	679,999	6,385	44.5	5.0	5.8	.2
$5,000 to $9,999	297,617	8,094	19.5	6.3	8.3	.8
$10,000 to $19,999	271,059	21,654	17.7	16.9	14.8	4.2
$20,000 to $29,999	109,523	21,193	7.2	16.6	10.4	6.6
$30,000 to $49,999	90,888	29,994	6.0	23.4	13.7	14.6
$50,000 to $99,999	47,582	25,286	3.1	19.8	12.9	21.8
$100,000 to $299,999	24,622	12,645	1.6	9.9	15.5	24.2
$300,000 and over	5,798	2,646	.4	2.1	18.5	27.6
Total	1,527,088	134,282	100.0	100.0	100.0	100.0

Source: Census of Business, 1935.

The position of small business in the service trades is analogous to that of small business in retailing. Service establishments are, for the most part, small businesses more than half of which are operated solely by proprietors and members of their families, since the volume of their receipts does not justify the employment of paid personnel. Of the total number of establishments covered by the census, 203,078, or 35.3 percent, reported receipts per establishment for 1935 of less than $1,000. An additional 226,834 establishments, or 39.5 percent of the total, reported receipts amounting to more than $1,000 but less than $3,000. These two groups represent 75 percent of the total service establishments, but they account for only $494,935,000, or 24 percent, of the total receipts. Establishments in these two size groups are operated by 442,002 active proprietors and firm members, or 76 percent of the total number of active proprietors and firm members of all service establishments.

The large businesses in service industries—those which reported receipts in excess of $50,000 for 1935—account for $464,877,000, or 23 percent, of total receipts, and represent 996, or 0.2 percent, of the total number of proprietors of all service establishments. It is important to note that a large majority of the establishments in this group are business-service establishments.

In the field of manufacturing we are restricted to corporate data. The following table illustrates the changes in sales relationships between 1932 and 1935.

TABLE 14.—*Gross sales (or gross receipts from operations) in all manufacturing corporations submitting balance sheets, 1932 and 1935*

Asset size	Percent increase in average sales	Total sales in each group as percentage of all sales		Number of returns in each group as percentage of total	
		1932	1935	1932	1935
$0 to $50,000	35.4	4.3	4.2	49.8	51.0
$50,000 to $100,000	48.5	3.5	3.4	15.3	14.4
$100,000 to $250,000	55.9	6.5	6.8	15.9	15.3
$250,000 to $500,000	60.9	6.0	6.7	7.9	7.8
$500,000 to $1,000,000	71.2	6.3	7.7	4.9	5.1
$1,000,000 to $5,000,000	70.1	15.0	18.5	4.7	4.9
$5,000,000 to $10,000,000	71.9	6.4	7.5	.7	.7
$10,000,000 and over	26.7	52.0	45.2	.8	.8
Total		100.0	100.0	100.0	100.0

Source: Statistics of Income.

Average sales increased for all groups, with a definite tendency for the larger firms to increase more than the smaller ones, (except for the class with assets of $10,000,000 or more). With the improvement of business conditions, the individual small concern handled relatively less of the increased sales, as the percentage increases indicate. On the other hand, examination of the proportion of total sales reveals that a relatively constant share of the market was retained by firms with assets under $250,000; this may be explained by the changing relationship between the proportion of firms and the proportion of sales in each group. The significant shift occurred among the larger corporations. Thus, sales of firms with assets between $250,000 and $10,000,000 rose from 33.7 to 40.4 percent of the total, whereas the share of the largest group decreased from 52.0 to 45.2 percent. Since the increase in average sales for all corporations was 43.8 percent, it seems clear that the relative loss was confined to the smallest and the largest group.

In the light of the concentration already noted in trade, it is well to observe that, at one extreme, 51 percent of the firms made 4 percent of the sales, and, at the other extreme, 0.8 percent made 45 percent of the sales.

Turn-over.

The rate of turn-over is a measure of the relationship between sales and working capital. In the following table, the rate of turn-over is the ratio of sales to current assets.

TABLE 15.—*Turn-over ratio in manufacturing corporations submitting balance sheets, 1932 and 1935*

Asset size	Returns showing net income		Returns showing no net income	
	1932	1935	1932	1935
$0 to $50,000	4.47	4.81	3.48	4.35
$50,000 to $100,000	3.72	3.98	2.55	3.22
$100,000 to $250,000	3.28	3.48	2.10	2.75
$250,000 to $500,000	3.06	3.15	1.83	2.44
$500,000 to $1,000,000	2.59	2.91	1.65	2.22
$1,000,000 to $5,000,000	2.29	2.52	1.52	2.11
$5,000,000 to $10,000,000	2.20	2.31	1.35	2.00
$10,000,000 and over	2.16	2.18	1.34	1.71

Source: Statistics of Income.

The rate of turn-over varies inversely with the size of firms; thus, the smallest firms with net income had sales of $4.5 for every dollar of current assets, while the largest had sales of only $2.2. This indicates a relatively high degree of liquidity in the operation of the small concern. This may be an indication of an improved position in the market or of a weaker position because of inadequate working capital. Ordinarily, a high turn-over is associated with high profitability; however, as has been shown, the evidence does not support this view. In our analysis of working capital, we have seen that the current position of small business is relatively weak; the volume of working capital in small firms declined sharply in the depression years and recovered only moderately. Accordingly, the high turn-over ratio may reflect merely an unsound "hand-to-mouth" form of operation.

Another aspect of the turn-over data is the relationship between net-income and no-net-income corporations. In each year and in each size group, firms with no net income had lower turn-over ratios. This indicates the potential importance of sales, since it is likely that an increased volume of business would have taken some concerns out of the deficit category.

Cost of Capital and Credit.

The economic and financial position of the small businessman is further weakened by the costs involved in obtaining capital. The inequalities in costs as between large and small firms are brought out in the S. E. C. record of 217 issues registered during 1937, as shown in the accompanying table. The expense of a common stock issue of less than $250,000 is 22 percent, whereas only 16 percent represents expense in issues of more than $1,000,000. For preferred stock and bonds, the discrepancy is even more marked. The result has been that only a small part of the need has been met in this way.

TABLE 16.—*Expense of security flotation, by size of issue, first 6 months of 1937*

Type and size of issue	Number of cases	Expense of issue (percent)	Type and size of issue	Number of cases	Expense of issue (percent)
Common stock:			Prefered stock—continued.		
Under $250,000	33	22.4	$10,000,000 to $24,999,000	2	3.3
$250,000 to $499,000	19	19.9	$25,000,000 or more	2	3.0
$500,000 to $749,000	21	19.1	Bonds, notes, and debentures:		
$750,000 to $999,000	10	18.2	Under $250,000	5	9.2
$1,000,000 to $4,999,000	22	15.7	$250,000 to $499,000	7	9.3
Preferred stock:			$500,000 to $749,000	5	9.8
Under $250,000	9	17.3	$750,000 to $999,000	2	4.2
$250,000 to $499,000	11	19.5	$1,000,000 to $4,999,000	15	4.8
$500,000 to $749,000	8	11.8	$5,000,000 to $9,999,000	3	4.8
$750,000 to $999,000	3	15.7	$10,000,000 to $24,999,000	13	3.1
$1,000,000 to $4,999,000	17	9.3	$25,000,000 or more	8	2.3
$5,000,000 to $9,999,000	2	3.7			

Source: Taken from J. L. Nicholson, "The Fallacy of Easy Money for the Small Business," Harvard Business Review, autumn, 1938, p. 33.

Even in cases where small enterprises have completed the registration process, there is evidence that in many cases the entire issue is never sold. Most large issues sell 100 percent of the registered amounts offered. However, in a S. E. C. survey of sales by small and unseasoned companies, a quite different picture is given.

Of the $321,000,000 of securities registered by the 584 registrants, only $74,000,000, or 23 percent, was sold within a period of about 1 year following the effective date of registration. Reports from 191 registrants show that none of the $105,000,000 of securities registered by them—about one-third of the total registration covered by this study—was sold. For the remaining 393 registrants reporting some sales, total sales of $74,000,000 were equivalent to 34 percent of the $216,000,000 of securities registered by them.[9]

[9] "Selected Statistics on Securities and on Exchange Markets," S. E. C., August 1939, p. 35.

The situation is similar with respect to the cost of credit. The following table indicates that interest rates vary inversely with the size of loan:

TABLE 17.—*Average size of commercial loans made at different rates, by groups of banks, Sept. 1–15, 1938*

Interest rate charged	Average size of loan			Interest rate charged	Average size of loan		
	New York City	7 northern and eastern cities	11 southern and western cities		New York City	7 northern and eastern cities	11 southern and western cities
1 to 2 percent	$88,000	$180,000	$65,000	4 to 5 percent	$18,000	$13,000	$10,000
2 to 3 percent	54,000	26,000	24,000	5 to 6 percent	5,000	6,000	6,000
3 to 4 percent	21,000	22,000	19,000	6 to 7 percent	3,000	2,000	3,000

Source: Federal Reserve Bulletin, January 1939, p. 18.

The importance of the marked tendency for rates to vary with the size of the loan is shown by the following table, which gives the percentage distribution of the number of borrowers according to the interest rate charged:

TABLE 18.—*Distribution of commercial loans, by interest rate charged, Sept. 1–15, 1938*

Interest rate	Percent of borrowers			Interest rate	Percent of borrowers		
	New York City	7 northern and eastern cities	11 southern and western cities		New York City	7 northern and eastern cities	11 southern and western cities
1 to 2 percent	35	4	3	5 to 6 percent	11	21	24
2 to 3 percent	14	6	5	6 to 7 percent	16	41	38
3 to 4 percent	12	9	8	7 percent and over	----------	1	12
4 to 5 percent	12	18	12				

Source: Federal Reserve Bulletin, January 1939, p. 17.

It is clear that a large proportion of borrowers are in the high-interest range; 16 percent of those borrowing in New York City paid interest at 6 percent or more, while 42 percent in the North and East, and 50 percent in the South and West, were in the same category.

Further evidence in support of this view is to be found in the changing rates of interest income from loans.

TABLE 19.—*Interest income from loans of national banks (as percentages of total loans)*

	Fiscal year		
	1929	1934	1938
Central Reserve city banks	5.1	3.5	2.7
Reserve city banks, total	5.8	4.7	4.2
New England, eastern, and midwestern	5.6	4.1	3.3
Southern, western, and Pacific	6.0	5.3	4.9
Country banks, total	6.5	5.9	5.6
New England, eastern, and midwestern	6.1	5.6	5.2
Southern, western, and Pacific	7.1	6.5	6.2

Source: "Current Comments," Federal Reserve Board, Apr. 23, 1940.

Interest rates received on loans by banks have shown much smaller declines among country banks than city banks. In spite of ample funds, some areas continue to receive very high rates. A partial explanation is that country banks make smaller loans, on the average, than do the city banks; since small loans bear higher interest rates, the interest income of country banks remains relatively high. In general, most of the decline in rates occurred in the first 5 years of the decade, partly because, in more recent years, banks have increased their personal loans, which bear higher rates of interest than business loans. The fact that the differential between the rates of Reserve city banks and country banks has increased suggests that there is considerably less competition in small towns than in large cities. This is an extremely important imperfection in the market structure from the point of view of the farmer and small businessman, since the local bank is often the only source of funds.

If the small businessman cannot obtain credit at his bank, his alternatives are limited to a few types of consumer credit agencies and business finance companies. Rolf Nugent, of Russell Sage Foundation, estimates that in 1938 consumer credit agencies had outstanding at least $75,000,000 in loans made for business purposes. The following table shows the estimated amounts outstanding for each type of agency and the range of interest rates:

TABLE 20.—*Business loans of agencies whose charges exceed normal banking rates*

Type of agency	Amount outstanding	Interest rates charged (percent)
Industrial banking companies	$20,000,000	12–30
Regulated small-loan companies	15,000,000	24–42
Personal loan department of banks	20,000,000	7–20
Credit unions	6,000,000	10–18
Axias	9,000,000	12–20
Pawnbrokers	5,000,000	9–60
Total	75,000,000	

While these agencies do not exhaust the sources to which businessmen apply for credit, they are representative because of their high charges. Probably a much greater volume of credit is extended by installment finance companies, factors, and miscellaneous business financing agencies.

Trade Credit.

Probably the most important type of nonbank credit to small firms is trade credit. Trade credit comprises credit stemming from goods bought for resale and inventory, and from the purchase of equipment. It is thus both short and long term. The dominant form is the short-term trade credit which provides working capital, though there seems to be a trend toward financing investment goods such as store fixtures, soda-fountain equipment, and refrigerating units through long-term trade credit.

The reliance by small businesses on trade credit is a mixed blessing. There are several important disadvantages in using trade credit, all of which add to the cost of doing business.

The weaker the financial position of a firm, the greater is its dependence on trade credit. Firms which can pay cash are in a position

to bargain for price and quality concessions. Those businesses which must depend on trade credit must buy only where they can obtain credit. These firms are thus buying both goods and credit and will not be able to obtain either on terms as favorable as the firm which buys only goods and obtains its credit requirements from a bank. The ability to buy from different suppliers is important in the competitive struggle, and those firms which are tied to a small number of suppliers are in the position of having to buy from what is, in effect, a group of monopolists, while their competitors can buy on the competitive market. Firms which must depend largely on trade credit exist as mere outlets or satellites of the large suppliers.

During cyclical fluctuations, firms dependent upon trade credit are in a particularly bad position. At a time when they need credit most, they cannot obtain it. They are, moreover, always faced with the possibility that their suppliers may lose "confidence" and press for immediate payment both of interest and principal. Their position at these times is especially precarious. Firms with long-term debt, on the other hand, have merely to meet interest payments and hence are shielded from the devastating effects of changes in "business confidence."

BANKING POLICY AND THE NEEDS OF SMALL BUSINESS

The banks' decision to lend will be determined primarily by two factors—the risk of the loan and the profitability of the loan. The risk involved in making a loan depends upon the nature of the assets securing the loan. If the assets are highly liquid, the risk is small. On the other hand, if the assets which are used as collateral are fixed, or subject to rapid depreciation, the risk involved is considerable. A bank making a loan secured by collateral of the latter sort, will demand collateral with a value more than the face of the loan, depending upon the bank's estimate of the depreciation of the assets and what it would probably bring in cash if it had to be liquidated. Hence the use of a current ratio as a criterion of soundness.

The profitability of a loan depends upon the cost of making the loan (clerical, legal, administrative) and the rate charged. The cost of small loans per dollar loaned will in most cases be higher than large loans, since the administrative expenses are fixed. For these two reasons banks find it less desirable to loan to small businesses.

In general, small businessmen require funds in order to improve or maintain their position in the market. In the short run, this may mean repair of plant and equipment, payment of taxes, expansion of inventory, or repayment of short-term loans and trade credits; in the long run, this may involve replacement of existing plant and equipment, refunding of debts on easier terms, or retirement of existing debts. In either case, they need funds for periods much longer than the usual 1- to 3-month commercial loan.

The Hardy-Viner report [10] indicates that almost 60 percent of applications rejected by banks were for working capital. The following table shows this:

[10] Availability of Bank Credit in the Seventh Federal Reserve District, 1935, p. 9.

TABLE 21.—*Distribution of rejected loan applications, by purpose of loan*

Type	Number rejected	Percentage of total rejected	Type	Number rejected	Percentage of total rejected
Working capital	1,071	59.9	Financial institutions	28	1.6
Fixed capital	94	5.3	Miscellaneous	24	1.3
Both, or undesignated	87	4.9			
Commercial	420	23.5	Total	1,788	100.0
Refinancing	64	3.6			

Source: Hardy & Viner, Availability of Bank Credit in the Seventh Federal Reserve District, 1935.

A working-capital loan is defined as one which finances a continuing series of transactions, while a commercial loan is made to finance a single self-liquidating transaction or a group of such transactions to be completed within a relatively short period. Thus, it seems that the bulk of applications was for credit to finance the continuing operations of the business. This is substantiated by an unpublished study of the Reconstruction Finance Corporation on the duration of loans desired by 1,000 rejected applicants. Of 827 cases where the length of loan was specified, only 6 wanted funds for less than a year and only 161 for less than 5 years. On the other hand, 242 requested 5-year loans, 159 fell between 5 years 1 month and less than 10 years, and 182 asked for 10-year loans. The assets of small businesses consist of plant and machinery on the one hand and inventories and receivables on the other. During the depression, banks especially have laid great emphasis on liquidity; thus security in the form of fixed assets has been viewed with disfavor. Receivables are generally unsatisfactory to banks unless they are composed of a few good accounts.

There are a number of legal and practical considerations which limit the acceptability of both inventories and receivables. In a review of rejected R. F. C. applications conducted by the Department of Commerce,[11] it was pointed out that:

> In order that chattel mortgages on inventories may provide a practicable security, they should (1) permit the sale of goods in the usual course of trade and (2) cover goods acquired to replenish stock that is sold. According to a survey made by the Legal Division of the R. F. C., however, there are only eight States where such security is acceptable from a practicable point of view. In nine States, a chattel mortgage covering a fluctuating stock of goods exposed for sale is absolutely invalid, and in all the others, including the District of Columbia, the steps necessary in order to maintain a valid and effective lien are too complicated (or too uncertain) to be practicable. In all States except the eight first referred to, a chattel mortgage on inventories does not constitute satisfactory collateral unless the goods are warehoused. The latter requirement would probably make it impossible for retail businesses to continue operations in the majority of cases.
>
> As already indicated, accounts receivable are, in general, acceptable as security by the R. F. C. except where they are composed of so many small or delinquent items that administrative costs would be prohibitive or recoveries doubtful. Unfortunately, the latter conditions obtain with respect to many small retail businesses desiring credit.

In this connection, it should be observed that, if the collateral position of the small manufacturing concern is bad, then the position of the small wholesaler or retailer is much worse. The latter have most of their assets in the form of inventories and receivables and only a small portion in mortgagable plant or equipment. The emphasis on liquidity

[11] Cited in hearings on S. 1482 (Mead bill), 76th Cong., 1st Sess.

and negotiability of collateral thus restricts the potential volume of credit, since few small businessmen will be able to meet banking requirements.

Table 22 indicates the reasons given by banks for refusal of loans. One of the main reasons is "inadequate working capital," generally defined as too low a ratio of current assets to current liabilities. This current ratio shows how much can be currently realized from the sale of merchandise and the collection of receivables for every dollar that must be paid out currently in meeting short-term obligations. A current ratio of 2.0 is ordinarily considered adequate by bankers, since there would be sufficient funds available to meet current obligations even if the current assets should shrink to one-half their stated value or be converted into cash half as rapidly as was anticipated.

TABLE 22.—*Reasons given by banks for refusal of loans* [1]

Reason:	*Percentage of all cases*
Loan policy of bank	4. 9
Earnings	19. 2
Inadequate working capital	36. 8
Unsatisfactory customer relationship	12. 5
Inadequate net worth	40. 3
Speculative or promotional	9. 6
Character of business	2. 5
Indebtedness to closed banks	2. 5
Past insolvency	5. 7
Character of management	14. 5
Loan too slow	19. 5
Real estate	1. 8
Not customer of bank	6. 1
Cause unknown	2. 2
Examiner criticism	8. 1
Collateral unsatisfactory	16. 1
Loan to transfer indebtedness	1. 1
Other reasons	3. 6

[1] The percentages given in the tables are the ratios of number of times the particular reason was given to the total number of cases in the group. As the average number of reasons per case is more than 1, the percentages in each case add up to more than 100.

Source: "Report on the Availability of Bank Credit in the Seventh Federal Reserve District," 1935 (Hardy-Viner Report), p. 10.

A Department of Commerce study,[12] based on reports from firms employing no more than 250 workers, shows that credit difficulties were experienced even by firms with high current ratios. In 1929, 58.3 percent of these establishments had ratios of 2.0 or higher, while in 1933, 43.3 percent fell in the same category, with 23.4 percent showing ratios of 3.0 and over. It must be remembered that some industries are more liquid than others; those having a number of "turn-overs" annually may be expected to show greater liquidity than those having only a seasonal or annual "turn-over." Moreover, some industries suffer more severely than others from the effects of depression.

Inadequate net worth—"too much debt"—accounts for 40 percent of the refusals shown in table 22. The usual measure of inadequacy is the "net worth-to-debt ratio." The difference between total assets and total obligations, representing net worth, is expressed as ratio to total obligations. This indicates how much the owners have invested for every dollar obtained from creditors; it measures, than, the rela-

[12] "Survey of Reports of Credit and Capital Difficulties Subscribed by Small Manufacturers," 1935, p. 57.

tionship between owners' equities and creditors' claims and is of particular interest from the long-run view of ability to pay. In this area of "opinion" or "policy" we find a large proportion of loan refusals. (See table 22.) Such reasons as "Earnings," "Character of Management," "Loan too Slow," "Loan Policy of Bank," or combinations of these and other reasons probably account for at least one-third of the rejections. Unfortunately, there are no specific criteria which can be applied generally to determine willingness and ability to pay, apart from past experience. One of the decisive factors here is the bankers' attitude toward the future, since this colors their approach to the problem of each applicant.

Again turning to the Department of Commerce study, we find that in 1929, 57.2 percent of the firms had net worth-to-debt ratios of 2.0 and over, while in 1933 51.3 percent were in the same class. There appears to have been a considerable stability in these small firms during the depression. It must be remembered that the net worth-to-debt ratio includes the more permanent factors in each case, while the current ratio reflects the immediate situation; hence, it is significant of stability that the decline in the number of firms with sound net worth-to-debt ratios was less than in the case of current ratios. Nevertheless, these firms had difficulty in obtaining credit.

Correlating the ratios, we find that 18 percent of firms reporting credit difficulty had both current and net worth-to-debt ratios of 3.0 or over, while 33 percent had both ratios at 2.0 or over.

Table 23 shows borrowing establishments classified by size and credit ratios. In the smallest group, 51 percent reported credit difficulty, as compared with 40 percent in the largest group. Again, in the smallest group, 30 percent of those firms with current ratios of 3.0 and over had difficulty, as compared with only 18 percent in the largest group. These relationships hold for the net worth-to-debt ratios as well. Thus, size of firms is closely related to credit difficulties.

TABLE 23.—*Borrowing establishments classified by size and credit ratios, showing the percentages that reported credit difficulty in each size and ratio group, 1933*

Number of employees	Percent reporting difficulty—current ratio						
	Total	Under 1.0	1.0 to 1.4	1.5 to 1.9	2.0 to 2.4	2.5 to 2.9	3.0 and over
21 to 50	50.9	76.7	67.2	66.0	52.0	49.0	29.8
51 to 100	43.7	76.6	68.3	56.9	51.8	47.0	22.6
101 to 250	39.8	79.9	62.0	56.3	45.6	35.1	18.4
Total	44.8	77.5	66.1	60.0	49.9	44.0	23.3
	Net worth-to-debt ratio						
21 to 50	50.9	68.3	68.0	63.5	56.6	52.3	35.8
51 to 100	43.7	69.0	67.9	57.4	55.3	62.4	26.1
101 to 250	39.8	61.1	63.1	59.4	64.6	34.8	25.0

Source: "Survey of Reports of Credit and Capital Difficulties Submitted by Small Manufacturers," Department of Commerce, 1935, p. 52.

This conclusion is further substantiated by a study on the "Availability of Bank Credit" by the National Industrial Conference Board. Their conclusion is that a very high proportion of the large concerns having capital over $1,000,000 reported either no experience or no

difficulty in obtaining bank credit. On the other hand "credit refusals and restrictions reported were largely confined to the groups classed as small and very small, that is to concerns with capital of $500,000 or less." The small and very small concerns, as this is defined, accounted for only 51.9 percent of the total number of concerns reported. But they accounted for 81.2 percent of all credit refusals or restrictions. If size is measured by number of employees per firm, the report showed the following:

Number of employees per firm and percent of credit refusals or restrictions in each group

20 and under	19.5
50 to 100	14.3
101 to 250	13.5
501 to 1,000	2.6
1,000 and over	.6

The study of the Department of Commerce previously referred to examined the Dun and Bradstreet ratings of 620 firms which reported difficulties in securing credit and whose net-worth-to-debt ratios were 2 or more. It was found that 38 percent of these firms were rated "high" and that 26 percent were rated "good." "In other words, almost two-thirds of these firms might be considered acceptable credit risks on the basis not only of their reported financial condition, but also of their credit worthiness as judged by the efficiency of management and by willingness to pay obligations at maturity."

It cannot, therefore, be doubted that credit difficulty is inversely correlated with size of firm. Moreover, it has been shown that there are many small firms which are sound even by orthodox banking standards, yet cannot obtain sufficient credit.

In the past, banks have financed the purchase of fixed assets knowing that the money could be repaid only very slowly out of profit. A similar policy was pursued with respect to working capital, with full realization that inventories, receivables, and supplies will never be liquidated so long as the business remains a "going concern." In the normal course of events, inventories are sold and accounts are collected frequently, so that money comes in just as in the case of a true commercial loan ("one turn-over"). However, the money cannot be used to repay a working-capital loan without restricting business operations. Inventory is usually replaced as it is sold, while one set of receivables is replaced by another. It was common practice to allow such loans to run on for several years, so long as interest was paid and the principal gradually reduced. The present difficulty arises out of the nature of these working capital loans, which, while ostensibly short-time, are in reality long-run advances by the banks.

At the same time, pressure for liquidation of old debts by the banks aggravates the situation. Many borrowers who, during the depression, kept up payments of interest on their debts and made small payments on the principal, are faced now by a steady sapping of their working capital in order to repay their old debts.

The sharp decline in business activity from 1929 to 1933 and the slow recovery since then has had the effect of diminishing the demand for credit and making the banks more cautious in their general lending policies. The relationship between business and the banks changed from a debtor to creditor status. Long-term loans fell off sharply, as well as short-term advances to small business firms.

Evidence for these statements is found in the Twentieth Century Fund Study—"Debts and Recovery." In 1930, the peak year as regards total corporate debt, the amount owed by corporations was estimated at $75,000,000,000. Of this amount, $48,000,000,000 represented long-term loans and $27,000,000,000 short term. By 1934, the long-term loans in the industrial group had declined to $21,300,000,000, or 44.4 percent of the 1930 level. The short-term loans declined to $22,500,000,000 or 83.3 percent of the 1930 level. In 1929 business debts in commercial banks comprised 60 percent of all debts owed to banks including both short- and long-term debts. By 1936, however, business debts had declined to 33 percent of all debts.

Even short-term business borrowing declined drastically. Loans of commercial banks "representing chiefly short-term borrowings of small business houses" are placed in June 1929 at $16,200,000,000. By June 1934 these loans had declined to $6,200,000,000. It is estimated that these short-term loans had risen by late 1937 to about $8,400,000,000, not quite half of their 1929 volume.

In 1929 business apparently owed the banks some $12,500,000,000 more than it had on deposit, and in 1933, $4,400,000,000; but in 1936, business had $2,300,000,000 more on deposit than it owed the banks; and even with the loan expansion of 1936–37, business still had a slight creditor balance in 1937.

Equity Capital.

A business enterprise can obtain additional funds in several ways. It can plow profits back into the business, it can obtain credit from the banks or by selling debentures, or it can try to obtain funds from investors by selling stock. If most small businesses made a profit, there would probably be no credit problem for them. Since commercial banks take the view that they can grant funds only to "sound" business and since most small businesses are not "sound," this source is largely closed to them. The last private source is the capital markets. But this of all sources has been perhaps the least important to small business. It certainly is so to today. The opinion of both private and Government authorities agree on this point. Thus, Mr. Edward E. Brown, president of the First National Bank of Chicago, before the Senate Banking and Currency Committee, declared: "In my opinion, it has always been difficult for small business to get risk capital. I think the difficulties today, for a variety of causes, are greater in getting proprietary risk capital for small- and medium-sized businesses whose capital needs are not large enough to warrant the expense of a public issue." The evidence from S. E. C. registrations already mentioned is concrete illustration of the fact that the capital markets are simply not organized for small issues, and consequently closed to small businesses.

PRESENT GOVERNMENTAL AIDS

The present system of Government aid to small business is vested in two agencies: The Reconstruction Finance Corporation and the Federal Reserve System. They are dealt with in their stated order.

In June 1934 Congress passed an act liberalizing the loan policy of the Reconstruction Finance Corporation and the Federal Reserve Board (Public, No. 417, 73d Cong.), adding section 5d to the R. F. C. Act and section 13b to the Federal Reserve Act.

Reconstruction Finance Corporation.

The act authorized the R. F. C. to make loans to any solvent industrial or commercial business established prior to January 1, 1934. The maximum amount to any one borrower was set at $500,000; as for security, the law provided merely that it be "adequate." Loans were limited to 5-year terms and could be made only when credit at prevailing rates was not available "at banks." The R. F. C was authorized to make these loans directly, in cooperation with banks, or by the purchase of participations from banks.

Some of the more significant administrative regulations set up to clarify the act provided that loans were to be made "primarily to supply needed working capital * * * as contrasted with fixed capital," [13] and that loans could not be made if the proceeds were to be for repayment of existing debt, for construction or repairs, or for payment of taxes. "Adequate security" was to consist of either a first mortgage on real estate, plant and equipment, chattels, or "assignment of current accounts or notes receivable, trade acceptances, warehouse receipts on merchandise stored in bonded warehouses, or a first lien on other assets of sound value acceptable to the Corporation."

In April 1938, an act was passed permitting the R. F. C. to purchase securities from businesses. Security for loans does not seem to be specifically required, the law stating merely that loans must be of "sound value" or secured. Chairman Jones insisted that this did not mean that R. F. C. would make character loans and interpreted the law as prohibiting unsecured loans.[13a] Limits on the maturity of loans were removed, as well as limits on the amount outstanding at any one time. As to eligibility, wording of the section was changed to allow loans to any "business enterprise," rather than merely to any "industrial or commercial business." The clause limiting loans to cases "deemed to offer reasonable assurance of continued or increased employment of labor" was omitted, but the loans were to have as an added purpose "promoting economic stability of the country." Borrowers were eligible when credit was "not otherwise available," the words "at banks" having been struck out.

In the revised circulars which the R. F. C. issued [14] to explain the changes in the law, it was stated that loans were to be made for a term not longer "than is justified by the facts of the particular case," but long enough to enable the borrower to plan for the development of his future business without impairing his working capital.[15] More important, the loans could be made not solely for working capital, as before, but also for replacement of equipment or purchase of new machinery, "when it is shown that such capital expenditures are necessary for efficient operation and are economically sound." Even loans for new business enterprises and for expansion were to be given consideration by the R. F. C., if they likewise could be shown to be economically sound. The only remaining restrictions were that the R. F. C. would not make loans to business enterprises in receivership "unless it were to end the receivership and restore the business to a solvent condition," or to finance the development of new inventions.

[13] R. F. C. Circular No. 13: Information Regarding Loans to Industry, June 1934.
[13a] Hearings on H. R. 4012 (H. R. 3383), Feb. 7, 8, 9, 1939, to extend functions of R. F. C., p. 9.
[14] Circular No. 13 and Circular No. 15, revised April 1938.
[15] The regulations stated that for shorter term credit, loans "usually should be repaid within 5 years or less. When loans are primarily to finance capital expenditures, a longer repayment program may be considered." Circular No. 13, revised, p. 1.

"Acceptable" security for loans, as set forth in the regulations, included only first mortgages on real estate, plant, or equipment, chattels, assignment of warehouse receipts, or accounts receivable. As additional collateral, "any other assets of sound value" were acceptable. The regulations also stated that the tangible net worth of the business enterprise "should be in an amount proportionate to the loan requested." The circular defined "securities" that could be purchased by R. F. C. as referring only to bonds with definite promises to pay and definite maturity dates, and with the same restrictions applying as to loans.

R. F. C. procedure.—The prospective borrower makes an application at one of the 32 field agencies of the Corporation. A preliminary application may be filed with the following information: purpose of loan, bank connections and bank indebtedness, recent efforts to obtain bank credit, description of collateral, income and balance-sheet accounts, officers of the company (their net worth, insurance carried by them for benefit of the applicant). Usually this form is sufficient, although in the case of larger companies a formal application with much more detailed description is necessary.

The application is referred to an examiner; if the nature of the collateral requires, an appraiser may be called in. The examiner writes a report and makes recommendations which are submitted to the agency manager and a group of local businessmen, comprising the directors of the agency. The application and report of the examiner are reviewed and further recommendations made.

The papers are then sent to the Washington office, where another examiner goes over them and submits his report to a review committee. This group makes its recommendations to the R. F. C. Board, which passes final judgment. If the application is rejected, the reasons are submitted at once to the local agency and thence to the applicant. If approved, the papers and a resolution adopted by the Board are sent to the agency. The applicant discusses the terms and if everything is satisfactory to him, he furnishes the necessary papers (notes, titles, mortgages, etc.). The case is then transferred to the "custodian bank"—the Federal Reserve bank of the district—which can then disburse the funds.

Results.—No information has been published by the R. F. C. as to size of the borrowing firms, but the size of the loans authorized has been cited as proof that the small businessman has been given a great deal of consideration. The following table [16] shows loans authorized (and commitments outstanding as of June 30, 1939) from February 2, 1932, to June 30, 1939, inclusive, by size of loans to business enterprises (excluding banks, utilities, and railroads).

The table shows that 57.8 percent of the dollar volume of loans authorized was for loans of more than $200,000, although this group constituted only 4.3 percent of the total number of loans. Loans of $100,000 or less were 30 percent of dollar volume of loans and 91.2 percent of total number of loans authorized. Loans in the category $5,000 or less comprised 36.9 percent of the number of loans and only 1.5 percent of the dollar volume.

[16] "Quarterly Report of R. F. C.," June 30, 1939, p. 50. The amounts shown include loans to fishing industry and loans to business through mortgage-loan companies and banks, under sec. 5.

TABLE 24.—*Total loans and authorizations of the R. F. C. to business enterprises, Feb. 2, 1932, to June 30, 1939*

Size of loans	Number of loans	Percent of total	Amount authorized	Percent of total
			(Millions of dollars)	
$5,000 and under	3,023	36.9	6.8	1.5
$5,001 to $10,000	1,277	15.6	10.3	2.3
$10,001 to $25,000	1,542	18.8	28.1	6.2
$25,001 to $50,000	928	11.4	36.5	8.1
$50,001 to $100,000	694	8.5	54.0	11.9
$100,001 to $200,000	366	4.5	55.3	12.2
$200,001 to $500,000	257	3.1	83.0	18.4
$500,001 to $1,000,000	39	.4	130.7	28.9
Over $1,000,000	61	.8	47.5	10.5
Total	8,187	100.0	452.2	100.0

While the total amount authorized by R. F. C. since February 2, 1932, totaled $452,000,000, actual disbursements were only $180,242,000. Assuming that the distribution of disbursements is the same as that of authorizations, the total disbursed in loans of $50,000 or less would be about 32.6 million dollars. Since this figure refers to a period of more than 7 years, it can be seen that small business has received little aid from the R. F. C.

The greater amount of money disbursed moreover, has been disbursed since June 1934 under section 5d. The amount authorized under this section (up to June 30, 1939) was $351,000,000. Of this amount about one-half—$174,000,000—was disbursed. Thus, prior to June 1934, only $6,000,000 had been disbursed to business enterprises by the R. F. C. Of the total authorizations, $267,000,000 were in the form of direct loans and $85,000,000 represented purchases of participations in bank loans to business enterprises (since June 1934). The banks' share in these participations aggregated $40,000,000, so that total loans to business with the aid of banks was $125,000,000, or roughly one-third of the total authorized aid. While bank participations have been higher in 1938 and 1939 than in previous years, they are still of minor importance in comparison with the total credit extended by the banking system.

The bulk of the discrepancy between authorizations and disbursements is accounted for by withdrawals and cancelations. R. F. C. reports indicate that, in all industries, the proportion of total authorizations withdrawn amounts to 21.4 percent. Marked variations occur among industries, from a low of 8 percent in paper and allied products to a high of 64 percent in cotton warehousing.

Many reasons have been offered to explain this discrepancy. According to R. F. C. officials, an important factor is the ability to get credit elsewhere; the borrower may use the R. F. C. authorization as a means of convincing his bank that he is a good risk. This suggests that R. F. C. policy is considered "sound" by bankers, since they will accept R. F. C. recommendations in making loans. Another possible explanation is that businessmen prefer to deal with banks in the community because of their constant banking needs; if there is only a small spread between R. F. C. rates and bank rates, the businessman may prefer to build up his local standing by borrowing from the bank.

Again it has been suggested that the borrower may be interested merely in getting the best offer of R. F. C. and then withdraw because

he can get more favorable terms elsewhere. Still another factor is that the final terms offered by R. F. C. may be different from those originally proposed by the applicant. In view of the complicated nature of administrative procedure this might well be an important factor.

Federal reserve loans to industry.

Provisions of section 13b.—The section as passed provides that, "in exceptional circumstances," when a Federal Reserve bank is satisfied that an "established industrial or commercial business" in its district cannot secure loans "on a reasonable basis from the usual sources," the bank may "make loans to or purchase obligations of such business," or make commitments to do so. Such loans or obligations may be for the purpose of providing the business with working capital only, and are not to have maturities in excess of 5 years.

In addition, the section empowers each Federal Reserve bank to discount for, or purchase such obligations from, any financial institution in its district, or to make loans to the financing institution on the security of such obligations, or to make commitments either to so discount, purchase, or make loans. This action is conditional upon the financing institution's obligating itself (to the satisfaction of the Federal Reserve bank) to pay 20 percent of any loss sustained by the Federal Reserve bank on the obligation. The existence of loss is to be determined by Federal Reserve Board regulations. If the financing institution prefers, it may, instead of obligating itself for 20 percent of the possible loss, advance 20 percent or more of the working capital, i. e., participate in the loan to that extent, without obligating itself to the Federal Reserve bank for loss on the Reserve bank's part of the loan.

The act provides for the appointment in each district of an industrial advisory committee to which all applications for loans, advances, and purchases must be submitted, such committee to be appointed by each Federal Reserve bank, subject to the approval of the Federal Reserve Board. The committees consist of from three to five members, each "actively engaged in some industrial pursuit" in the district. This advisory committee is authorized to examine the would-be borrower's business, pass on the applications, and transmit them with its recommendations to the Federal Reserve bank for final approval.

Regulation "S".—After conferences called by the Federal Reserve Board with the chairmen and governors of the 12 Reserve banks, regulation "S" was issued covering the "direct loans to industry" section, with the statement that Congress had recognized "the need for many small and medium-sized industrial and commercial businesses for additional working capital to enable them * * * to maintain employment or provide additional employment." The Board left entirely to the Federal Reserve banks what constitutes an "established commercial or industrial" business, and the defining of the term "working capital." In addition, the Board, to eliminate the necessity for having loans approved in Washington, allowed the Federal Reserve banks to grant loans and make commitments directly without referring them to Washington. Each Federal Reserve bank was left to make up its own application forms and its own requirements as to information and documents to be furnished by the applicant.[17]

[17] Discounts, Purchases, Loans and Commitments by Federal Reserve Banks to Provide Working Capital for Established Industrial or Commercial Businesses (Regulation "S") June 26, 1934.

The regulations stressed that the Federal Reserve banks must ascertain to their satisfaction that the borrowers' financial needs were for working capital, that the borrowers' financial condition and credit standing, and the value of the security offered, if any, justified the loan. Security was not necessarily required, the law having stated merely that the loans be "on reasonable and sound basis," and each Federal Reserve bank was to set up its own standards in this respect. The regulations specifically say that the Federal Reserve bank must ascertain, before making direct loans or commitments to make loans or to participate in bank loans, that the "circumstances are exceptional," and, as in the case of section 5 (d) of the Reconstruction Finance Act, that the obligor cannot obtain the assistance "on a reasonable basis from the usual sources."

On issuing regulation "S," the Board stated that "it is expected * * * that the Federal Reserve banks will not compete with local banks, but will rather assist them in meeting local requirements for working capital," and that "it was agreed that these loans would be chiefly to small and medium-sized enterprises, which have the greatest need for such assistance * * *." [18]

Loans and commitments made.—The following figures show total applications for loans and participations received and the total approved, by years from 1934.

TABLE 25.—*Applications received and approved by Federal Reserve System, 1934–39*

Year	Number of applications		Percent of applications approved
	Received	Approved	
1934	5,053	984	20
1935	2,562	1,009	40
1936	764	287	38
1937	298	126	42
1938	659	247	37
1939 (May 31)	96	60	62
Total	9,432	2,713	29

Approved applications for the entire period therefore constituted 29 percent of the total applications received. These figures show that, after the first 6 months of operation, about 40 percent of all applications were approved, and suggest that the decline in loans approved resulted from the decline in applications and not from any change in policy by the Federal Reserve banks. No information had been published by the Federal Reserve Board as to the number of informal inquiries made which were discouraged before they reached the stage of formal application.

The Philadelphia Reserve Bank, for example, has reported that of 2,497 inquiries received by the end of 1938, only 652 formal applications, or 26 percent, were actually filed. Of these only 191 were approved, and because of cancelations, only 127 were ever disbursed.[19]

As of January 17, 1940, $405.8 million had been applied for, and $188.8 million had been approved. Of this, only $21.7 million of Federal Reserve bank advances and commitments were still outstand-

[18] Press release, Federal Reserve Board, June 28, 1934.

[19] Survey of Credit and Capital Requirements Among Small and Medium-sized Business Establishments, Third Federal Reserve District, Department of Research and Statistics, Federal Reserve Bank of Philadelphia, November–December 1938, p. 2, p. 47.

ing. The largest amount of advances and commitments outstanding at any one time was 60 million, at the end of 1935. The emphasis in the act is on enabling banks to increase their loans to industry, and the direct Federal Reserve loans were to be made only "in exceptional circumstances." In most cases of applications for direct loans the Federal Reserve banks usually have attempted to interest a local bank either in making the loan and then securing Federal Reserve participation, or in participating in the Federal Reserve loan. However, during the first year most of the advances were direct loans.[20] Although figures published by the Federal Reserve Board do not separate purchases of or participation in bank loans from direct loans, there were at no time more than $12.8 million of the financial institutions' share of these participations outstanding, plus about $1.7 million of guaranties by financial institutions of Federal Reserve bank loans purchased from them.

Although the Federal Reserve Board had stated, in issuing regulation "S" at the beginning of the program, that loans would be made chiefly to small and medium-sized enterprises "which have the greatest need for such assistance" [21] the Reserve banks appear to have rejected a larger proportion of applications from small borrowers for small loans than of applications from medium-sized and larger borrowers. The Philadelphia Reserve Bank reported that concerns of medium and large size have predominated in obtaining these loans "principally because they were able to demonstrate a reasonably sound basis for obtaining this credit in spite of weakened financial positions." Fifty-one percent of the loans made by the Philadelphia bank were for less than $25,000, 81 percent were for less than $100,000, and 45 of the borrowers, or 35 percent, had a net worth of less than $100,000. However, concerns with net worth of less than $50,000 totaled 58 percent of the rejected applications, and those with net worth of less than $100,000 accounted for 72 percent of all rejected applications.[22]

The fact that, for all Reserve banks, up to January 17, 1940, only 30 percent of the applications received had been approved, whereas 47 percent of the amount applied for had been approved, indicates that a great many of the smaller loans were rejected. Of the loans and commitments that were approved, according to figures published at the end of 1937, 23 percent were for $5,000 or less, 36 percent were between $5,000 and $25,000, 29 percent were between $25,000 and $100,000, and 12 percent for over $100,000.[23] A remarkable feature of the loan history of 13b is found in the increasing size of the loans extended. The following figures give the average size of the loan applications approved by all Federal Reserve banks (industrial advances and commitments):

[000 omitted]

1934	$50. 4	1937	$88. 6
1935	74. 2	1938	97. 3
1936	53. 4	1939	103. 2

If the average is representative of the size trend of individual loans, it suggests a reorientation away from small business as the program developed.

[20] Federal Reserve Bulletin, June 1935, p. 339.
[21] Press release, Federal Reserve Board, June 28, 1934.
[22] Third Federal Reserve District Survey, op. cit., pp. 51, 56, 64.
[23] Twenty-fourth Annual Report of the Board of Governors of the Federal Reserve System, 1937, table 14, p. 61.

Results claimed for the Federal Reserve industrial loan program.—No estimates have been made as to the probable amount of employment created by the Federal Reserve industrial loans, although the Philadelphia bank reported that 35 of the 60 borrowers who had repaid their loans in full by the end of 1938, had been able to maintain employment in their plants as a result of the loans, and 30 had been able to restore their credit with trade and the local banks. The Philadelphia bank reported also that only 7 of their 127 borrowers had been placed on the "trouble" list, and that 5 had petitioned for bankruptcy.[24] The New York bank reported, also at the end of 1938, that nearly two-thirds of their borrowers showed definite improvement of their position after receiving the loan, but that one-fifth showed continued deterioration.[25]

From time to time Reserve bank officials have claimed that the program stimulated banks to make loans independently that they otherwise would have refused. Many Reserve bank officials feel that the downward trend in applications indicates that credit requirements are being satisfied and that sound potential borrowers who cannot get loans for working capital do not exist.[26]

At no time have there been more than 32 million of Federal Reserve bank advances outstanding; hence, if there did exist over the period 1934–39 any substantial unsatisfied demand for credit, the Federal Reserve program has certainly been of little significance in meeting it. The reason most usually cited for the small volume of loans and of applications for loans has been the limitation of the law restricting advances to those for working capital purposes. Suggestions were made from time to time by interested observers that the law be amended to allow loans for permanent capital purposes. Although Federal Reserve banks were allowed some leeway in defining working capital, for the most part they seem to have defined the term rather strictly.[27] The restriction of the loans to 5-year terms and to businesses already established has also been held to have hindered approvals of loans otherwise eligible.

Comparison of R. F. C. and Federal Reserve loans to industry.—At the end of June 1939 the Federal Reserve banks had authorized a total of only $179,800,000 in loans and commitments, compared with $351,100,000 in loans and participations authorized by the R. F. C.

The great increase of R. F. C. loans over Federal Reserve loans to industry came after April 1938. This can be explained by the liberalization of the R. F. C. law, particularly the clause allowing loans for permanent capital purposes. The difference between the approvals made by the two agencies prior to that time can be explained in part by differences in policies of the two organizations. Even before 1938, "incidental" portions of the R. F. C. loans could, according to R. F. C. regulations, be made for permanent capital purposes or repayment of existing debt, since the law specified that the loans were not limited in the law to "working capital." On the other hand, the R. F. C. Act

[24] Survey of Credit and Capital Requirements Among Small and Medium-Sized Business Establishments, Third Federal Reserve District, Department of Research and Statistics, Federal Reserve Bank of Philadelphia, November–December 1938, pp. 59–61.

[25] Twenty-fourth Annual Report, Federal Reserve Bank of New York, for the year ended December 31, 1938, pp. 23–24.

[26] Journal of Commerce, June 8, 1939.

[27] The New York Federal Reserve Bank, for example, frequently approved applications calling for the use of as much as 10 percent to 25 percent of a loan for machinery and repairs, but not as much as 50 percent to be so used. New York Times, Mar. 6, 1938.

specifically requires "adequate security" whereas section 13-b of the Federal Reserve Act does not, although security was generally required as a matter of policy. It may be that the change in the R. F. C. law in January 1935, enabling R. F. C. to lend to newly established enterprises increased the number of loans made, and that extension of the maturity period from 5 to 10 years may have contributed also to this increase. As early as 1935, there were cases where borrowers who had been turned down by the Federal Reserve bank were able to get a loan from the R. F. C. There is some evidence that the Federal Reserve banks have not been willing to make loans to businesses which have been in poor condition for the past few years, while the R. F. C., according to its chairman, has been somewhat more optimistic about the future of such businesses.[28]

The following tabulation shows the differences between the provisions of law under which the two agencies at present make loans to business enterprises:

	Federal Reserve banks [1]	Reconstruction Finance Corporation
Type of business	An industrial or commercial business	Any business enterprise.
Age of business	An established business	New and established businesses.
Financial status	No provision	Solvent, in the opinion of the Board of Directors of the Corporation.
Credit position	Unable to obtain requisite financial assistance on a reasonable basis from the usual sources.	When credit at prevailing rates for the character of loans applied for is not otherwise available.
Purpose of loan	For working capital	For "maintaining and promoting the economic stability of the country or encouraging the employment of labor."
Maturity of obligation	Not over 5 years	No limit.
Security required	"On reasonable and sound basis"	In the opinion of the Board of Directors of the Corporation, of sound value or so secured as reasonably to assure repayment or retirement.
Amount of funds available	$280,000,000	None specified.
Amount of any 1 loan	No limit	No limit.
Form of transaction	(a) Direct loan; (b)[2] Discount for or purchase from financial institutions; (c)[2] Advance to financial institution on the security of such obligations; (d)[2] Commitments with regard to such loan or advance to financial institution.	(a) Direct loan. (b) Loan in cooperation with bank. (c) Purchase or agreement to purchase participation. (d) Purchase of securities from businesses.

[1] Revision of table appearing in Availability of Bank Credit in the Seventh Federal Reserve District op. cit. p. 30.
[2] (b), (c), and (d) require 20 percent participation of financial institution in the risk.

It is clear that both R. F. C. and the Federal Reserve banks are operating in the same area and with essentially the same powers, although R. F. C. is less restricted by statute than the Reserve banks. The Hardy-Viner report [29] declares "that the making of direct loans to industry is a responsibility which ought never to have been put on the Reserve banks * * *, because the extension of this type of credit is fundamentally inconsistent with the more important functions and responsibilities of the Reserve banks * * * (they) are obviously put in an embarassing position when they are required to make loans which, because of length of term, would be deemed doubtful or inappropriate for the member banks."

[28] Testimony of R. F. C. Chairman Jesse Jones at hearings on S. 2343, before the Senate Banking and Currency Subcommittee on R. F. C. Affairs, June 29, 1939, and at hearings on H. R. 4240, to extend the functions of R. F. C., January 21, 1935, p. 5.
[29] "Availability of Bank Credit", op. cit., p. 38.

At the same time, the report recommends specific changes in procedure and policy if the Federal Reserve banks are to continue making industrial advances. The purpose of law would be better served, says the report, if lending officials adopted a broad view in the case of loans to clear up existing debt, where forced liquidation of existing loans can be prevented or where procurement of needed capital will be facilitated.

The work of the industrial advisory committees, made up of businessmen from the Reserve district, is essentially a duplication of the work of the lending officers and results in divided responsibility, as well as in compelling the applicant to be judged by two tribunals. There is, moreover, a tendency for the committee to place initial responsibility upon that member who comes from the general area in which the applicant's business is located. This is extremely undesirable, especially since the members are likely to be "sound" businessmen who may not be very sympathetic to the needs of their smaller or less "sound" associates. This criticism applies with equal force to the composition of R. F. C. local agencies.

R. F. C. policy also leaves much to be desired. Audits and appraisals should be limited to applications for fairly large loans, since this activity increases already high costs for technical assistance arising from legal work on titles to property and preparation of mortgages. The present R. F. C. policy of requiring "subordination" is a serious hurdle from the view of both time and expense. Mortgage holders must be induced to waive priority and agree to create a first lien in favor of R. F. C. This is a very difficult obstacle, since mortgage holders may not feel that their own position will be improved as a result of an R. F. C. loan. It would be preferable, if indeed this type of protection is needed, that R. F. C. accept an agreement to share collateral. This would simplify considerably the problem of obtaining waivers.

The present centralization of R. F. C. activity in Washington is extremely unsatisfactory from the borrower's point of view. Much waste of time and effort results from this practice. Moreover, the proportion of rejections in Washington may result in a conservative attitude on the part of local examiners. The Hardy-Viner report has already recommended that the Washington office of R. F. C. be limited to (1) consideration of policy, (2) hearing appeals, (3) unusually large loans, and (4) cases of disagreement among the members of the local agencies. Such a change would leave considerable discretion to the agencies. This would not be dangerous since the central office would still exercise general supervision of local activity.

SUGGESTED AIDS

In European countries the special credit and capital requirements of the small firm have been recognized and steps have been taken to aid small business for many years. In this country, however, it was not until 1934 that any attempt to meet the problem was made. As already indicated, Government aid to small business has been thus far unsuccessful. In the past few years, a number of bills which

would provide additional aid to small business have been introduced in Congress.[30]

The proposals take three main forms: (1) The supplying of equity capital through Government purchase of the stock of small businesses; (2) the extension of long-term credit to small businesses by an agency of the Government; and (3) insurance by the Government of private loans.

Equity Capital Proposals.

Equity capital can be provided through Government or private agencies purchasing preferred stock of small businesses. The argument for this proposal is that small businesses are already loaded with debt, and an extension of credit would simply add to their burden. Moreover, credit would involve a rigid system of interest and amortization payments, independent of the varying business fortunes of the small concern. Preferred stock, on the other hand, would be cheaper and more flexible, insofar as it would involve no fixed payments of any kind.

Private sources must be ruled out as a practical method of providing equity capital at the present time. Objection is raised to the Government's undertaking this task, on the grounds that it would be entering business as a part owner of the concern. However, the Government could receive nonvoting preferred stock so that it would not have to set up an administrative mechanism for participation in the direct control of the business.

The short duration of business life of many small concerns and the fact that the Government would have no claim on any specific assets but only on the unimpaired assets of the business raises the question of the possible losses that might be incurred. Preference as to assets would in part eliminate this difficulty, but the rate of return on stock of this kind should in theory be sufficiently higher than the interest rate on loans so that any additional losses would be covered by the additional profit from the successful firms.

Direct Loan Proposals.

The idea behind these proposals is that it would be easier for the Government than for private sources to extend credit to small business. The Government would not necessarily be seeking a profit from the loan and could more easily carry the risk burden which is involved in loans to small business. Moreover, the Government can lend in greater volume than any single private source and thus minimize the possibility of loss through a better distribution of risks. These proposals recognize that private sources cannot or perhaps will not grant sufficient credit to small concerns at the present time.

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[30] H. R. 9291—Creation of an intermediate credit corporation (Kuppleman, February 1, 1938).
H. R. 9325—To establish a U. S. Industrial Loan Insurance Corporation (Reed, February 1938).
S. 3430—To provide insurance by R. F. C. of loans by banks to business enterprise (Pepper, February 9, 1938).
H. R. 9441—To authorize national banks to underwrite or participate in investment of new issues (Barry, February 10, 1938).
S. 3630—To establish a system of regional industrial banks (Pepper, March 8, 1938).
H. R. 3520—To enable banks to make capital loans to small business (Brown, January 31, 1939).
S. 1482—To provide for R. F. C. insurance of loans by banks to business (Mead, February 17, 1939).
S. 1743—To provide for a Federal investment bank and local association to extend credit to business (Logan, March 8, 1939).
H. R. 5429—To empower R. F. C. to guarantee character loans made to merchants by local banks and by Federal Reserve Banks (Jeffries, March 28, 1939).
H. R. 5910—To set up industrial finance banks (Voorhis, April 20, 1939).
S. 2998—To establish a permanent industrial loan corporation to assist borrowing institutions in making credit available to commercial and industrial enterprises (Mead, October 31, 1939).

262652—41—No. 17——17

The direct loan schemes differ from each other on the issue of using existing agencies or creating new ones to administer the program. The plans which favor existing agencies provide that the R. F. C. or the F. R. B. lend to small firms on more liberal terms. The advantage of such plans is that the organizations are already set up and would therefore involve less delay and expense in getting the program going. On the other hand, the utilization of existing facilities and personnel would tend to bring to bear in the operation of the plan, the full weight of orthodox banking practice. The effectiveness of any plan depends in part upon the people and facilities who put the plan into practice. It is argued by those advocating the creation of new agencies that this factor would restrict the volume of loans to small business regardless of any new powers that might be authorized. Even a new agency would be free of this objection, however, only if the personnel and high administrators were indeed free of the orthodox banking bias. On the other hand, it would suffer from the organization difficulties of all new agencies and would be open to the charge of unnecessary duplication of facilities.

Insurance Proposals.

The central feature of all the insurance plans lies in the attempt to obtain the requisite funds from private banking sources. This would make the fullest use of existing facilities and would eliminate the necessity of setting up extensive administrative machinery for field investigation. These proposals differ in two ways: (1) The type of agency; and (2) the type of insurance. The type-of-agency differences in this case also revolve around the issue of creating a new agency or using present facilities. The need for administrative decisions would not be entirely eliminated under this arrangement and the effectiveness of the plan would be limited by the restrictions on the types of loans insured. Thus the argument for new as against existing agencies are much the same as those already mentioned under direct loans.

The type-of-insurance differences hinges on the issue of guaranteeing a specified portion of every loan or insuring each loan completely but limiting total payments to a specified proportion of the total loans insured.

The first plan would insure every loan a bank made to the extent of a specified proportion, say 90 percent; then the maximum insurance would be 90 percent and banks would in every case of failure bear 10 percent of the loss. The second plan would guarantee each loan 100 percent but the maximum Government insurance would apply to only a part of the total volume of loans. The maximum percentage which the Government should insure under this plan could best be worked out in practice. In the housing field, the experience of F. H. A. indicates that 10 percent is sufficient insurance; in the small business field a somewhat higher percentage might be necessary. This method would probably produce a greater volume of loans than the other method of insurance. It would also be more costly, unless the percentage of failures exceeded the proportion of loans insured by a percentage greater than the ratio of the uncovered to the covered proportion of each loan insured under the first plan.

It is not within the province of this report to choose between alternative plans to help small business. But it should be emphasized that any credit or capital program to help small business must be

part of a wider program to stimulate business activity and employment. Small business needs a wider market as well as funds to enable them to compete for and hold a larger portion of the present market. If the economy as a whole does not rise to higher levels of employment and business activity, the effectiveness of any capital or credit program will be greatly reduced.

SUMMARY AND CONCLUSIONS

A high proportion of enterprises in this country fall in the category of "small business." The problems of this group are in part those of all business and center on the need for a larger market. There is one field, however, in which it is alleged that small business has special problems—the field of capital and credit. Many small businessmen feel that their needs for equity capital and long-term credit are not being adequately met at the present time. The holders of disposable funds, on the other hand, feel that prospective losses make investment in these small enterprises too risky. From the social point of view, the issue is one of far-reaching importance. This report will attempt to bring together all available information that bears upon this controversy and in the light of this knowledge to analyze the questions of public interest that are involved.

In general, business concerns can obtain additional capital in several ways—by reinvesting earnings, by turning to the capital markets for sale of securities, or by borrowing from banks. The efforts of small business firms to tap these sources, however, have been comparatively unsuccessful. The depression greatly reduced the possibility of obtaining capital from earnings; many small firms have had to take losses in recent years. The organization of the capital markets gives little or no access to this source of funds, as the cost of floating securities is prohibitive when the amount of the issue is small. Borrowing from banks has also become a less satisfactory source. Small bank loans carry higher rates than large loans. With the advent of the depression in 1929, moreover, banks have placed more emphasis on liquidity as a basis for extending credit. Receivables and inventories, which usually are the most liquid assets of small businessmen were unsatisfactory collateral to the banks in many cases. The general emphasis on liquidity has increased the difficulty of small firms in obtaining credit both for short- and long-term uses.

The banks, however, take the view that "virtually no small business or medium-sized business which is entitled to credit—either for a short or a long time, and which can give reasonable assurances of repayment—fails to get it." [31]

It is clear that the truth of this statement will be determined by the meaning of the phrase "entitled to credit." Those who reason from the private, profit-motive standpoint define "entitled to credit" in terms of "soundness" or risk. "Sound" small businesses are those which satisfy the criteria that have been established by bankers through long experience with the risk and profitability of various types of loans and investments. Thus, the needs of "sound" small businesses are met.

On the other hand, from the viewpoint of small businessmen themselves, or an organization not primarily interested in making a profit

[31] Statement of Mr. E. E. Brown, president First National Bank of Chicago. Hearings on S. 1482 (Mead Bill) 76 th Cong., 1 st. Sess.

from loans or investments, these criteria of soundness are not necessarily determinate. This report has shown that there are small businesses "whose credit standing at the present level of business activity does not make them acceptable risks for banks. These are not misconceived, or mismanaged, or insolvent businesses, but businesses whose prospects of success are dimmed by the current economic situation."[32] Moreover, there is a minor proportion of small businesses which, even though "sound" on banking standards, yet cannot obtain credit. A Department of Commerce study of small firms reporting credit difficulties found that 620 had net-worth-to-debt ratios of 2 or more; the Dun & Bradstreet ratings of approximately 40 percent of these firms were "high," and another 25 percent of them were "good."

From a direct and immediate standpoint, what is needed to resolve this conflict is a demonstration of the relative economic efficiencies of small businesses and large businesses. It goes almost without saying that such a demonstration, covering all lines of business, under all possible general conditions that may ensue, cannot be made at the present time. All that can be shown is that a certain degree of validity inheres in each of the interacting causes which contribute to the relative deterioration of the small-business position.

Small firms generally have been hard hit since the beginning of the depression. Their working capital is inadequate and has been a decreasing proportion of the total for more than a decade. This is shown by an increase in the proportion of working capital held by 316 manufacturing firms with assets over $3,000,000. In the decade 1926–35 their share increased from 35 to 46 percent of the total working capital held by all manufacturing corporations submitting balance sheets to the Bureau of Internal Revenue. There is a definite decrease in liquidity with decreasing size. The current assets-current liabilities ratio brings this out quite clearly. In 1936, for example, this ratio was 1.33 for corporations with assets of less than $50,000 and 7.26 for corporations with assets of over $50 million. Small concerns can best finance themselves only on a short-term basis, whereas the larger corporations can obtain long-term funds at favorable terms. In 1936 current liabilities were 77.7 percent of all borrowed capital for corporations with assets under $50,000 and only 21 percent for corporations with assets of $50 million and over. Analysis of net worth reveals that, for every dollar of assets, the small concern has a smaller proportion of invested capital than the large firm. Thus, in 1936 the proportion of equity to total assets (for the above classes) was 43.6 percent for the smaller class and 76.3 percent for the larger class. In other words, small firms obtain a relatively larger share of their capital by borrowing, as opposed to the more permanent investment represented by equity capital. As a result, the small firm is more vulnerable to cyclical fluctuations, which have increased greatly in amplitude in recent years.

It is, therefore, reasonable to suppose that a substantial part of their difficulty is due, not to secular factors which would be difficult to control, but to the severity and duration of the depression of 1929–33 and the laggard recovery of the later years. Their weakened position becomes all the more serious because of their inability to obtain funds with which to take advantage of the recovery when it

[32] E. E. Draper, Board of Governors, Federal Reserve System, Washington Post, October 1, 1939.

comes. The process becomes cumulative. The impact of the depression becomes multiplied because of restricted credit and capital facilities. Reserves are depleted and they are unable to wait out the lean years. The recovery, did not enable small business completely to regain their former position. Rather, it strengthened the position of large businesses relative to small firms. Thus, small firms were hit harder and recovered more slowly, with the result that their competitive position deteriorated. Their poor economic and financial position is in part a reflection of this depression-recovery experience.

There can be no denying the fact that the long-run trend of the competitive battle in most lines has been against small business. The small businessman has been displaced from entire industries. Today, small business is concentrated in retail and wholesale trade, service, and some branches of manufacturing industry.

It is clear, of course, that in industries in which mass production dominates for technological reasons, the small business cannot hope to compete unless it becomes a large business. On the other hand, there are no a priori valid reasons to suppose that in all industries the large unit is the more efficient from an operating viewpoint. Retail trade, for example, is still predominantly conducted through small units and to a large extent will continue as a small-business industry. Although the chains and larger firms have been making headway, relatively to the small businesses, their progress has been such that it does not seem likely that they will obtain the major portion of the market for many years. In 1935 the sales of independents in retail trade were approximately $24,300,000,000. Sales of chains were $7,600,000,000. The increase in the proportion of chain sales from 1929 was only 2.8 percent. Other examples may be pointed to in branches of manufacturing industry which still have a great many small firms. Among them are food products, women's apparel, knit goods, auto accessories, and paints.

Thus, although some small businesses are in a poor financial condition because of relative long-term economic inefficiency, there certainly is no evidence to warrant the conclusion that all those who are in a poor condition are so because of their economic inefficiency. The battle does not always go to the concern with the greater operating efficiency. A common example of this is cutthroat competition. Prices of finished goods may be cut to uneconomic levels, or prices of materials bid up to uneconomic levels. The concern with the greater financial reserves wins this struggle. This concern is not necessarily the one that can produce more cheaply in the long run.

It must be recognized that by and large, efficiency of operation is only one factor in the problem of small business, and a factor moreover not independent of the ability to obtain funds when most needed. Financial strength itself is an important factor in business success, especially during an era of severe business contractions and slow recovery. The firm that cannot tap the community's supply of long-term capital except at high cost, and that cannot rely upon an immediate short-term credit when opportunity knocks, is evidently at a disadvantage for that reason alone. The role of capital and credit in business expansion and success should not be underestimated. Whatever other causes may have contributed to the weakness of small business, this may be recognized as an essential factor.

Thus, both the contradictory positions on this problem are reasonable when considered from their particular viewpoints. The logic of those who take the small business view is that insufficient capital creates unsoundness and contributes to the inferiority of their competitive position. The logic of those who take the orthodox invesment view is that small businesses cannot obtain term credit or equity capital precisely because they are economically and financially unsound. Thus, the one view is that a cause of the poor condition of small businesses is their credit and capital difficulties; the other view is that their credit and capital difficulties are a result of their poor condition. But the central economic issue of the relative operating efficiencies of small and large units cannot be demonstrated in favor of either side, so that the problem cannot be resolved at this level.

What is necessary is a consideration of all the elements from a social point of view. From this viewpoint, it is clear that one of the really important difficulties making small business "unsound" can be alleviated. To hold that the "unsoundness" or the poor condition of small businesses is due to their economic inefficiency, and that all "sound" small businesses obtain adequate credit and capital is very similar to asserting that all workers who are unemployed are submarginal and that any efficient worker willing to work can find a job. In either case, one factor is magnified to explain the entire problem. Making available to the small-business man more capital based on cheaper credit provides a means by which the community can continue to move forward. Denial that ultimately sound expansion can be achieved in this way implies that opportunity for growth in America is closed to small business or open only to big business.

It is believed, therefore, that since small business cannot obtain needed capital through existing facilities, the dilemma can best be solved by the Government. This is made advisable by the importance of the small-business sector of the economy, and by the urgency of their needs. It is made possible by the unimpeachable credit of the Government and the huge lending power of the banking system. It is made workable by the fact that there are many small businesses that are sound now and want long-term funds or will be sound if the national income increases and the needed funds are made available. Thus, a Government program designed to stimulate the activity of the entire economy should include and will be made easier by any measures that assist small business to obtain additional investment funds.

It was in recognition of the serious difficulties faced by small business that Congress authorized the Reconstruction Finance Corporation and the Federal Reserve banks to make loans to business directly or in cooperation with banks. However, these agencies have contributed only slightly to the alleviation of the difficulty. Of $450,000,000 in loans authorized by R. F. C. between 1932 and 1939, less than 4 percent were for loans under $10,000 and only about 30 percent were for loans under $100,000; at the other extreme, loans for $1,000,000 or more represented almost 30 percent of the total amount authorized. Actual disbursements in the 7-year period totaled only $180,000,000; if the distribution of disbursements assumed to be identical with that of authorizations, the total credit extended in loans of $50,000 or less was about $32,600,000 during the period. Obviously, the R. F. C. has done little to meet the needs of small business.

Similarly, the Federal Reserve banks, with $180,000,000 as the total authorizations and $32,000,000 as largest amount of advances outstanding, during this period cannot be considered important factors in this area.

A more effective program may involve direct Government loans, a system of loan insurance by the Government to encourage banks to expand their lending operations, or perhaps Government investment in small businesses through purchase of stock, preferably nonvoting preferred stock. Direct loans could be made on more liberal terms by existing Government agencies or by new agencies established for that purpose. Purchase of stock would eliminate fixed payments by the small business and would exact payment for the entire program from the successful firm but might be less advantageous to the Government. Insurance of private loans would make greatest use of existing facilities, but might fail to increase the volume of loans significantly if the insurance coverage were not high. The type of insurance that would produce the most loans appears to be that which guarantees each individual loan completely, but is restricted to some portion of the banks' total obligations. The experience of F. H. A. suggests that such insurance of a fraction of the loans, guaranteeing each completely, might be sufficient inducement for the banks to make the large volume of reasonably sound loans which they now hesitate to risk.

The success of any policy designed to aid small business depends in part upon the trend of general business activity. Small business cannot hope to be prosperous unless the whole Nation is prosperous. Consequently, a broad recovery program aimed at achieving full utilization of both idle labor and idle capital would greatly lift the level of sales and ensure that the assistance to small business would be a profitable rather than an unprofitable venture. The importance of greater sales volume is brought out by the facts uncovered in the study. The small manufacturing corporation which showed net income during the period 1931–36 had uniformly higher turn-over ratios than the concerns which showed no net income. The inference that many more would show net income if sales increased is therefore not unreasonable. This is likely to be true in retail trade also where 44.5 percent of the units had gross sales of less than $5,000 per year. A greater sales volume would in fact do much to solve the problem, provided small businesses can obtain the working capital necessary to maintain the increased volume of business before the expanded market is absorbed by their larger competitors.

CHAPTER XVIII

THE FINANCIAL PROBLEM OF SMALL BUSINESS[1]

INTRODUCTION

This report is an exploratory study of certain aspects of small business and its financial problems. While the problems of small business have long been familiar, little in the way of systematic study has been made of those problems. The difficulties of small enterprise in the modern economy of large-scale operation have given rise to much loose thinking, unproved assertion, and contradictory opinion.

What is small business? Is a small business one with assets of $5,000,000 or one with assets of $250,000 or is it a business with assets of less than $25,000? In what areas does small business predominate? Has it a special place in our economy? What kind of financial aid does small business require? Is it working capital or equity capital, or both? Are the commercial banks extending adequate short and long term credit? Is it a function of the commercial bank to make "capital loans"? Can the investment banking machinery as presently constituted be expected to distribute the securities of local small businesses? Does the investment trust offer possibilities for supplying equity capital to small business? Has it been used for that purpose?

If small business does not obtain capital and credit through these institutional channels, from what sources does it obtain its financing? Have the factor, the trade creditor, the accounts finance company and the personal loan company become the bankers for small business? Are their charges too high in relation to the services rendered? Has small business been placed at a disadvantage in relation to big business in its access to capital and credit as a result of the inadequacies of the existing financial machinery? Or are its disadvantages inherent in our economic and financial structure?

And not least in importance, what is the actual demand for financing on the part of small business?

Since the trend of American economic life appears to be in the direction of mass production, chain stores and the corporate form of business organization, why should we be concerned with preserving small independent businesses? Are they not doomed to extinction? Are not those who lament the passing of the corner grocer seeking to turn back the clock of progress?

It was to seek answers to these and similar questions that the present study was undertaken. As part of its agenda, the Temporary National Economic Committee directed the Securities and Exchange Commission to examine the capital and credit needs of small business.

Accordingly, in the Spring of 1939, the Commission's Investment Banking Section undertook this inquiry. Numerous methods of

[1] Prepared by Peter R. Nehemkis, Jr., special counsel, and members of The Investment Banking Section, Securities and Exchange Commission.

approaching the problem were considered. Should an intensive survey be made of one community? If so, what community? Or should the problem be attacked on a regional basis? The one-city survey was discarded since the conditions in any one city might not be representative of other parts of the country and the results would, therefore, be inconclusive. After weighing the various possible methods of inquiry, it was decided that the most satisfactory approach would be to "spot check" several regions of the country. It was believed that, by setting the concrete facts developed from such field studies against the facts developed from a statistical analysis of the existing data, a reasonably accurate general picture of the position of small business could be presented to the Committee. The following areas representing a wide variety of economic conditions were, therefore, selected: Fall River, Mass.; Scranton-Wilkes-Barre, Pa.; Detroit, Mich.; Omaha, Nebr.; Birmingham, Ala.; Dallas-Houston, Tex.; Denver, Colo.; Seattle, Wash.; and Portland, Oreg.

In the conduct of the field survey, the questionnaire as a method of inquiry was rejected in favor of the "case method." The latter, it was thought, would lend itself more effectively to concrete situations and would permit direct and personal contact with businessmen and bankers.

The study posed three questions: (1) What are the needs of small business? (2) Are these needs now being adequately met? (3) If not, how can they be met?

This study was carried out under the direction of Peter R. Nehemkis, Jr., special counsel to the Commission's Investment Banking Section.

Appreciation for suggestions and criticism is due to the following—to none of whom, however, is there to be attached any responsibility for the conclusions or opinions expressed: Dr. Winfield W. Riefler, Institute for Advanced Study; Roy A. Foulke and Edwin B. George, Dun and Bradstreet, Inc.; Thomas C. Blaisdell, Jr., director of research, National Resources Planning Board; Rolf Nugent, director, and John Hamm, assistant director, department of consumer credit studies, Russell Sage Foundation; Stuart Chase; J. Frederic Dewhurst, The Twentieth Century Fund; Charles O. Hardy, The Brookings Institute; Milo Perkins, president, Federal Surplus Commodities Corporation; Prof. William L. Nunn, University of Newark; Oscar Lasdon, associate editor, Bankers Magazine; Ralph W. Manuel, president, Marquette National Bank, Minneapolis, Minn.; Prof. William H. Steiner, Brooklyn College; Henry J. Eckstein, president, Foresta Factors, Inc., New York; Dr. Raymond W. Goldsmith, assistant director, Research and Statistics Section, Trading and Exchange Division, Dr. Morris J. Fields, senior financial economist, and David Ryshpan, financial analyst, Investment Banking Section, Securities and Exchange Commission.

The organization of the field studies, and the preparation of the statistical data was the work of Ernest Jerome Hopkins who also assisted in the writing of the report.

Other members of the staff of the Investment Banking Section likewise assisted in various capacities both in the work of the field studies and in the preparation of the report.

DEFINITION OF TERMS

This report is primarily concerned with the relationship between small business and the institutions of finance. Accordingly, the term

"business," as employed in this report, excludes the category of "finance."[2] Farms and homes are also excluded, as are government, social and professional enterprises and agencies. The railroads, power companies, and other regulated utilities are in a special category of business and, where included, are specifically treated as such.

The term "business", as used in this report, accordingly, refers to trade, manufacturing, service (except professional and governmental), construction (other than governmental), mining and quarrying.

In considering the term "small business," it should be borne in mind that it conveys not only a quantitative but also a qualitative meaning. Small business and big business are in many respects fundamentally different, and between the two there lies an intermediate zone. Precise boundaries with respect to size are difficult to determine; therefore, both the adoption of any single measure of business size, and the fixing of any dividing lines for major size groups, must needs be somewhat arbitrary.[3] However, as a matter of convenience, and also because significant statistical changes occur at about that general size-level, the "small" business unit, for purposes of this study, is defined as having less than $250,000 in assets. (Other measures of size, by number of employees, and by value of product in manufacturing, are also used in this report.)

"Intermediate" business consists of enterprises having from $250,000 up to $5,000,000 in total assets; and small and intermediate enterprises together are sometimes referred to as "the smaller units."

"Large" business embraces those units having $5,000,000 or more in total assets.

This classification of business into small, intermediate and large units is, of course, a quantitative one. Qualitative differences are equally important for purposes of definition; and these arise largely from differences in size. The qualities implicit in small business are those of the self-determined or independent owner-management. The typical small business unit is both owned and directly operated by its active proprietor or proprietors, with no overhead affiliations or control. Growth in size involves successive stages of hired management and submanagement, increasing remoteness of ownership from management, division of ownership among many persons, absentee ownership, and the impersonal quality, commonly associated with very large enterprise. The qualities of small business are seen most clearly in the simple one-man proprietorships, but they characterize the small- and medium-sized business partnerships and the smaller "closely held" business corporations as well.

The spread in operative size among business concerns is almost astronomical. To illustrate: In 1933, there were 982,184 small stores in retail trade, each with annual gross sales of $10,000 or less.[4] This may be compared to 14 large trade corporations which had, in that year, average gross sales of $168,738,714.[5] In 1936, the latest year for which the Bureau of Internal Revenue Statistics of Income were available at the time of preparation of this report, 173,674 of the smallest corporations in the business groups (those having less than $50,000 in total assets) averaged $50,420 in gross sales; the 88 largest

[2] This category includes banking, insurance, real estate, and all other forms of organized investment and brokerage.

[3] See Appendix 1, sec. II.

[4] See W. H. Meserole, Small Scale Retailing, Bulletin No. 100, Domestic Commerce Series, U. S. Department of Commerce; p. 1.

[5] See Statistics of Income for 1933, Bureau of Internal Revenue; p. 186.

corporations in the same groups averaged $178,094,380 in gross sales.[6] The total assets of the above 173,674 smallest business corporations averaged $17,950; those of the 88 largest averaged $230,960,390.[7] Fundamental differences in economic character and status are implied by such huge contrasts in operative size.

THE NUMBER OF SMALL ENTERPRISES

Total Number of Business Units.

Satisfactory figures on the total number of business establishments in the United States are not at present available. Pending the results of the 1940 Census of Business, an estimate of the number must be assembled from various sources. On this basis, according to the latest figures available, there were roughly 2,400,000 separate business units in the United States,[8] including approximately 300,000 corporations,[9] about 240,000 partnerships [10] and approximately 1,860,000 individual proprietorships.

In relation to the national population, the number of business units increased steadily from 1901, when there were 15.7 units per 1,000 persons in the United States, to 1926, when a peak was reached of 18.5 concerns for each 1,000 persons.[11] In 1927, this ratio began an uninterrupted decline, which continued until 1935, when there were but 15.6 business units per 1,000 of population. This was a thinner "business population" than at any prior time in this century. The heaviest mortality of businesses unquestionably occurred among the smaller units and especially among the individually owned concerns, which are by far the most numerous. Beginning in 1936, the business population again began to thicken, and by the middle of 1938 the ratio had climbed to 16.1 business units for each 1,000 persons. This was about where it had been in 1906. Inasmuch as the magnitude and variety of the nation's business activity had greatly expanded in the period under review, the failure of the business population to thicken commensurately is one indication of the established fact that heavy concentrations and integrations of business had characterized the entire period. At present the recovery in the number of business units relative to the population continues at a rate which, even if protracted, would not restore the highest ratio (1926) until approximately 1947.

Numerical Distribution of Business Units According to Size.

The smaller units of business enterprise are, numerically, overwhelmingly preponderant. Of the 2,400,000 business units in the nation, more than 92.5 percent are small (with less than $250,000 in total assets) and about 6.5 percent are intermediate (with $250,000 to $5,000,000 in total assets). Only about 1 percent of the business population, by almost any system of measure, is large business.[12] The distribution of the units of business according to size will be described in the following sections.

[6] See Statistics of Income for 1936, Bureau of Internal Revenue; pp. 100–117.
[7] See Appendix 1, table 2.
[8] See Appendix 1, tables 1–A, 1–B, 1–C, and discussion.
[9] There were 290,118 corporations in 1936, in trade, service, manufacturing, construction, and mining and quarrying. Appendix 1, table 5.
[10] There were 237,367 partnerships filing income tax returns in 1936. Statistics of Income, 1936.
[11] See Appendix 1, table 11.
[12] See Appendix 1, sec. II.

Marginal and part-time enterprises.—In this area there is an unknown number of very small home enterprises, part-time and side-line activities of the business type carried on by individuals who are not clearly recognized as being "in business" at all. Here may be included such activities as: The many homes in which a room or so is rented; the small lumbering, gravel-mining, inn-keeping, produce-vending, and other business side-lines of farms; the work of the occasional or semi-occasional dressmaker, carpenter, painter, or writer; peddling by children; the breeding and sale of pets by individual owners, which largely supplies the pet industry; the individual talent, skill, or "hobby" of an otherwise employed person which results in some degree of commercial production, trade, service or invention.

This marginal area of business life bulks larger, and is more important to the dynamics of the national economy, than is generally recognized. A considerable amount of work is performed by these unrecognized units, and they offer substantial competition to the more readily recognizable businesses; but of much greater significance is the function of this area as an economic seedbed. The small personal operation may be, and often is, embryonic of a larger business growth. Some of our largest business enterprises have emerged out of "basement" or "backyard" origins.[13]

The number of these part-time and marginal enterprises is unknown. Nor can the bulk of their activity be estimated on the basis of presently available data.

The non-employing enterprises.—This little-recorded penumbra of economic life which has been described grades over imperceptibly into an area of very small but clearly established business units which are operated entirely by their proprietors and their families. There are between 800,000 and 900,000 business units of this kind recognized as such by the Census of Business that are so small as to hire no employees.[14]

The employing enterprises.—According to the records of the Social Security Board, there were, in the first quarter of 1938, 1,516,009 employing units engaged in business as delimited by this study. These units each hired from one employee to 10,000 employees or more.

There were also 293,810 financial, professional and other "non-business" units,[15] making a total of 1,809,819 employing organizations filing returns for old-age and survivors' insurance. Of this grand total of 1,809,819 enrolled employing concerns, 122,890, or 6.8 percent, were only occasional employers, having reported some wages paid during the first quarter of 1938, but employing no workers at the conclusion of the quarter.

The enterprises having 9 employees or less at the end of the quarter, plus the occasional employers, numbered 1,546,094, or 85.4 percent of all the employing enterprises registered with the Social Security Board. An additional 128,143 employing enterprises had 10 to 19 employees. If we assume that small business by this system of measure consists of all concerns with less than 20 workers (no statistical coincidence with the $250,000 total assets measure being asserted), the total number of small employing units was 1,674,237, or 92.5

[13] Familiar, notable instances are the Ford Motor Co. and the Procter & Gamble Co.
[14] See Appendix 1, section I.
[15] These "non-business" establishments, while their number is of record, cannot be segregated from the size-group tabulations of the Social Security Board.

percent of the number of all employing concerns under the jurisdiction of the Social Security Board.[16]

In the intermediate-size group, it may be assumed that there are no employing concerns with less than 20 employees. The upper limit of this intermediate zone, by this measure, may be placed at the 799-worker establishment (again no statistical coincidence with the total-assets measure being claimed). This intermediate zone included, in the first quarter of 1938, 133,137 employing establishments of all types (including finance, professional, etc.). This is 7.4 percent of all employing concerns. An estimate of the number of *business* units in this zone is 85,000.

The remainder is large business. Allotted to it are the 2,445 largest employing establishments covered in the Social Security figures. These were less than 0.14 percent of the total number of employing establishments.

Distribution in manufacturing.—In the field of manufacturing the great multiplicity of small business units is confirmed by an additional, statistically unrelated, measure of size. This measure is the value of the annual product. In 1937, of a total of 166,794 establishments enumerated by the Census of Manufactures,[17] there were 1,653 concerns, or 1 percent of the total, each of which produced $5,000,000 or more in value of product for that year, and hence, by this measure, may be placed in the category of large business. There were 29,899 concerns, with annual product between $250,000 and $5,000,000 in value, which may be rated as intermediate. Small manufacturing concerns, with less than $250,000 product value per unit annually, numbered 135,242. The small business group in manufacturing, accordingly, comprised 81.1 percent of all establishments enumerated, and the percentage of intermediate-size manufacturing establishments was 17.9. These figures do not include an unknown number of yet smaller manufacturing concerns, producing less than $5,000 annually.

Distribution of corporations.—A like preponderance of small units is shown by the measure of total assets used in our definition, as applied only to those business units which are incorporated.[18] In 1936, there were 290,118 incorporated enterprises in the fields of trade, manufacturing, service, construction and mining and quarrying.

Of these corporations, 252,688, or 87.2 percent, possessed less than $250,000 of total assets and, accordingly, fall into the small-business classification. The intermediate sector, with assets running from $250,000 to $5,000,000, included 35,263 corporations, or 12.2 percent. Business corporations with $5,000,000 or more of total assets—the large ones—numbered 2,167 or less than 1 percent of all business corporations.

In this connection, it is exceedingly important to note that the incorporated establishments are but an approximate one-eighth of all business units in the Nation, and they are less than one-fifth of the number of all employing business units. The distribution of corporations by size, moreover, does not truly reflect the distribution of business as a whole, since virtually 100 percent of the large businesses, 40 percent of the intermediate businesses, and only 10 percent of the recognizable small businesses, are incorporated. In other words,

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[16] See Appendix 1, table 3. As previously noted, this figure includes some portion of the 293,810 non-business units, so it is to that extent an excessive figure for the business establishments above, as here defined.

[17] See Appendix 1, table 4.

[18] See Appendix 1, table 2.

corporations include the entire peak of the business pyramid, only part of its sides, and very little of its base. Hence, resort to corporation figures exclusively as a basis for stating the relative importance of small, intermediate and large business in respect to sales, assets, etc., would be misleading. The use of corporate data alone, in size-distributions, considerably exaggerates the importance of the big business sector, which consists almost wholly of incorporated units, and understates the economic significance of the overwhelmingly more numerous smaller units, which are, for the most part, individual proprietorships or partnerships.

PREVALENCE AND CHARACTERISTICS OF SMALL BUSINESS

Small business enterprises, then, constitute the vast majority of all business units. They do not, however, appear in equal numerical preponderance in all groups or subgroups of industry alike; small business has distinct preferences as to habitat.

Small business, is, in general, to be found wherever the capital requirement for adequate operation is small. It will be found wherever small-unit machinery or other equipment may be as efficient for the given purpose as the large and costly plant. Also, the personally operated type of enterprise is prevailingly to be found wherever the preference of consumers favors a product marked by some distinct individuality, a service involving personal contact, or an especially intimate response in other respects to the varieties of consumer demands. It is further found where the administrative advantages of largeness are not conclusive in determining survival.

These characteristics of the small business units may be seen more clearly by considering their relative position in the major divisions of business:

Trade.

Of the total of 2,400,000 business establishments in this country, considerably more than half are engaged in trade, retail or wholesale, or both. Trade, in spite of the severity of large-unit (chain-store, mail-order house, and department-store) competition, is still numerically the foremost stronghold of small business.

In 1936, among the 130,073 incorporated trade establishments alone, the larger ones having total assets of $5,000,000 or more, numbered only 337, or 0.3 percent.[19] The gross sales of these large units, however, comprised 25.1 percent of the gross sales of all trade corporations. There were 9,106 intermediate-sized trade concerns, or 7 percent of the total, with 36.2 percent of the gross sales. The remaining trade corporations—more than 92 percent of the total number—were small, with less than $250,000 in total assets; and these enjoyed 38.7 percent of the gross sales. (In considering these percentages for corporations only, the statistical bias in favor of the large units, previously mentioned, should be borne in mind.)

There are, in addition, many unincorporated trade units, mainly small and in many cases very small. While data precisely comparable are lacking, the Census of Business for 1935 states that there were 1,653,961 retail and 176,756 wholesale trade units (each unit within a multiunit establishment being individually counted)[20] whereas the total number of trade corporations (1936), as we have seen, was but

[19] See Appendix 1, table 5.
[20] See Appendix 1, table 1-A.

130,073.[21] Since the Social Security Board reports that in 1938 there were only 397,841 retail establishments in all in the employing trade group, there is obviously a very large number of trade establishments so small as to hire no workers. In this connection, it may be repeated that in 1933 there were 982,184 retail trade units, none of which exceeded $10,000 in gross volume of sales for that year.

This huge numerical prevalence of small and very small concerns in trade results primarily from economic adaptation. The requirements previously outlined are peculiarly favorable to small enterprise in this field. The requisite capital investment for trade is relatively small. Efficient equipment is on a small-unit basis, and mechanization is at a minimum. The convenience of location and service, direct contact with the consumer, and a close responsiveness to his needs, is also an important factor in the success of the small enterprise. Nevertheless, large administrative combinations and concentrations in the field of trade are offering increasing competition to the small, independent trade concerns. These concentrations rely heavily upon the administrative and financial advantages of largeness: bulk buying, bargaining power, reduction of overhead per unit of output, and superior access to capital and credit. The independent and small trade units nevertheless remain preponderant, and, moreover, in various localities are organizing so as to maintain their original advantage in this field, while also preserving their independent status.

Service.

This is the second largest stronghold of small business though small units are not present in all of its various branches alike. The service field is broad, including amusements, hotels and restaurants, cleaning establishments, the personal services, and various other non-commodity enterprises. Some of these fields embody areas of business concentration while others do not.

The Statistics of Income of the Treasury Department for 1936 show that in the service group there were 48,590 corporations of which only 246 could be classified in the large-business category—using total assets as a measure of size. These represented only 0.5 percent of the total number of incorporated service units, with 16.1 percent of the corporate receipts derived from operations. The intermediate size group of service corporations numbered 7,121, or 14.7 percent of the total, with 39.4 percent of the receipts. Small service corporations numbered 41,223, or 84.8 percent of the total, and accounted for 44.5 percent of the receipts.[22]

In this field, again, most of the establishments are unincorporated. The number of unincorporated units may be inferred from the contrast between the above total of 48,590 corporations in the service industries, and the Census of Business figures for 1935, which showed that all service units (not subtracting multiunit establishments) numbered 615,862.[23] In service, the number of nonemploying units is considerably less than in trade, the Social Security Board reporting the existence of 418,187 service establishments with employees in 1938. However, a considerable number of the remaining were evidently proprietor-manned.

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[21] Actually, there were roughly 145,000 trade corporations, the difference arising from the fact that all of them did not submit balance sheets.

[22] See Appendix 1, table 5.

[23] See Appendix 1, table 1-A.

The service field in certain of its branches also offers a favorable environment for small business. While a high degree of mechanization exists in some lines, by and large this sector relies upon individual skill and personality for its success in the competitive struggle. The tastes and wants of the individual consumer and the skill of the individual proprietor and employee are altogether controlling in certain service fields. Technological factors, however, play a more important part in some divisions of this field than in trade; small business, therefore, finds survival increasingly difficult where, as in the case of the central laundry, for example, large-unit investment and technology afford a competitive advantage.

Construction.

While the building supply industries, classed as manufacturing, include certain heavy concentrations, the construction industry itself is the least concentrated of business categories. Even among the 14,574 incorporated units, there were in 1936 but 31 construction corporations in the large business group (using total assets as a measure of size). These were 0.2 percent of all the corporations in this field, but they accounted for 10.5 percent of the gross receipts. The intermediate size group, with 1,066, or 7.3 percent of the 14,574 construction corporations in this field, accounted for 25.4 percent of the gross business.[24]

Of the 14,574 construction corporations, 13,477, or 92.5 percent, were small units, each having less than $250,000 in total assets. These reported 64.1 percent of the total sales in this field. In 1938 the Social Security Board found that there were 98,831 employing units in this industry, which, when compared with the 14,574 corporations, indicates an overwhelming preponderance of unincorporated units in construction.

Three factors explain the preponderance of the small unit in this major industry. First, mass-production methods have not yet been found especially applicable, partly because construction calls for an almost endless variety of performance. This in turn is partly accounted for by the variety of the technical problems encountered, which may resist standardization of method, and partly by the peculiar variety which characterizes the consumer demand for housing. In addition, construction equipment, although mechanized, is efficient in small units. It is largely of a portable nature, and in the main represents the non-fixed plant; the small assemblage of construction machinery is adequate and efficient for the particular tasks which it is called upon to perform. Finally, construction equipment adequate for many purposes may be acquired with a relatively small outlay of capital, and involves no very heavy fixed charges when not in use. Accordingly, the small units prevail in this industry, both numerically and in the total bulk of the nation's construction work performed.

Manufacturing.

This industrial division is obviously the focal point for many of the greatest business concentrations. Yet small manufacturing units are numerous and important. For manufacturing establishments, complete data for units with $5,000 or more in annual value of product are available from the Census of Manufactures. Using the value of

[24] See appendix 1, table 5.

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the annual product as the measure of size, and assuming $250,000 and $5,000,000 in product value to be the dividing lines of our size groups, it is found that, of the total of 166,794 manufacturing establishments, both incorporated and unincorporated, in 1937, with a minimum product value of $5,000, only 1,653, or 1 percent, were large, in that the product of each was valued at $5,000,000 or more for the year. These few large establishments, however, accounted for 42.8 percent of the total product value of all manufacturing included in the Census of Manufactures. The intermediate size group comprised 29,899 establishments, or 17.9 percent, and turned out 45.3 percent of the total value of product. Small manufacturing, with 135,242 establishments, or 81.1 percent of the total, each producing less than $250,000 in product value, accounted for 11.9 percent of the total product value of manufacturing tabulated.[25] How much the inclusion of the smallest manufacturing concerns (with less than $5,000 annual production) would affect these percentages, is unknown.

Included in the foregoing figures are the 85,350 incorporated manufacturing establishments for which additional data are available from the Statistics of Income. In 1936, there were 1,278 large manufacturing corporations with total assets of $5,000,000 or more, or 1.5 percent of the total number; these accounted for 53.9 percent of the gross sales of manufacturing corporations. The intermediate size-group, again measured in terms of total assets, contained 15,269 manufacturing corporations, or 17.9 percent of the total, and accounted for 32.5 percent of the gross sales. The number of small corporations in this field was 68,803, or 80.6 percent of the total, and they accounted for 13.6 percent of the gross sales.[26]

The foregoing embodies data for all types of manufacturing. If manufacturing is broken down into its component sub-divisions, the percentages of small-unit participation are found to vary considerably, and the requirements of the small-business *milieu* are further illustrated. Again having in mind the caution previously expressed to the effect that the size-group figures for corporations alone do not adequately portray the part played by the smaller enterprises, the preferred habitat of small business in the various subdivisions of manufacturing may be indicated for the corporations.[27]

Small business in manufacturing in 1936 ranged from 92.0 percent of the total number of corporations in the clothing and apparel industry, and 89.4 percent in the printing and publishing industry, to 66.3 percent of the corporations in paper and pulp production, and 63.2 percent in petroleum and oil production.

The percentages of gross sales varied widely in relation to the numbers of units distributed by size. In the petroleum and oil products, tobacco products, and the motor vehicle industries, the small corporations, though constituting from 63.2 percent to 74.2 percent of the total numerically, made only from 1.2 percent to 4.6 percent of the gross sales. In chemical products; metal and its products; food and kindred products; stone, clay and glass; paper and pulp; textile mill products; and liquors and beverages, the small corporations (between 66.3 percent and 82.1 percent of the total numerically) accounted for 10.5 percent to 16.1 percent of the gross sales. The intermediate corporations emerged with 30.6 percent to 53.5 percent of gross sales.

[25] See Appendix 1, table 4.
[26] See Appendix 1, table 5.
[27] See Appendix 1, table 6.

In leather products; printing and publishing; forest products; clothing and apparel manufacture; and the unclassified or assorted manufacturing group, the small units were from 77.5 percent to 92.0 percent numerically, and their gross sales were from 22.5 percent to 52.7 percent of all the corporation gross sales in those branches of manufacturing. Since the intermediate units in the last named groups further accounted for 40.8 percent to 52.9 percent of all gross sales, the minor position of the large corporations is emphasized, and the ability of the smaller units to adapt themselves to these forms of manufacturing becomes startlingly clear.

The underlying reason for this is, again, that the environmental factors in the manufacturing fields last mentioned are peculiarly favorable to small enterprise. The machinery used in garment-making, printing, planing, leather-working and the other groups in which the smaller units are strongest, is of the type which is virtually as efficient in small or medium-sized shops as in the large factories. The huge printing plant, for instance, merely has more linotypes, not larger or more efficient linotypes, than has the small plant. Indeed, in such industries not only may the investment necessary for efficiency of plant be relatively small, but the small units may have an efficient technological base. Again, small plants of these types may and do alter their output and their operations with comparative ease, in order to produce specialties in conformity with changes in consumer demand. In this connection, the huge expenditure for the wholesale overhauling of plant and equipment required by the Ford plant in order to turn out the first model A car comes readily to mind. Contrast this with the little cooperage concern encountered during the course of the field study, which when the barrel-making business ceased to pay, used a part of its existing equipment for cleaning and renovating old barrels, and soon found itself in the "black" again.[28] Similar is the case of the small feather concern which, crowded by competitors in that industry, turned to the manufacture of shuttlecocks used in the game of badminton, and is now one of a scant few concerns successfully engaged in this business.[29] Small enterprise may have less hull than the full rigged corporation, but, like the racing yacht, it carries greater spread of sail, has lighter draft, and can change its course more swiftly. Such factors contribute to the variety of product which enables small concerns to serve a shifting market and profit by changes in style, varieties of demand and even individual orders. This ability to change without undue disruption of operations helps to explain the amazing vitality which frequently characterizes the small enterprise.

Mining and Quarrying.

A general inquiry into this industry made in the course of the field study,[30] resulted in the conclusion that an environment favorable to the small enterprise is not found under present conditions in mining, although it does exist in quarrying. Mining has largely become a deeprock operation requiring large capital and costly smelting equipment. Quarrying, however, being a surface operation, the smaller units find it possible to compete successfully. Figures from the 1936 Statistics of Income covering this field as a whole show that 8,555 mining and quarrying corporations, out of a total of 11,531, fell into

[28] See Appendix 2, III, p. —.
[29] See Appendix 2, VI, p. —.
[30] In the Rocky Mountain and Pacific Coast States.

the small business category. However, 275 large corporations accounted for 57.3 percent of the gross sales of the industry, as compared with only 8 percent for the small establishments.[31]

Transportation and Public Utilities.

In transportation, a striking illustration is afforded by the characteristic ability of small enterprise to seize upon a new small-unit invention, susceptible to operating integration, flexible in its response to demand, and with drastic competitive consequences to established large enterprise. The invention of the automobile and the truck presented small enterprise with a technological weapon which it has used effectively to make tremendous inroads into the railroad and traction field, which formerly was notably the abode of big business. The ability of the motor vehicle to respond more intimately to the needs of the public, and at small capital outlay, were vital factors in the success of small business in this area.

A somewhat similar development has now begun to take place in the electric utility field. Its technological basis is the small-unit generator, which is being utilized by many small municipalities, cooperatives and individual factories and apartment houses to make important inroads into the regional monopolies of the power companies.

ECONOMIC CONTRIBUTIONS OF SMALL BUSINESS

From the foregoing discussion it is apparent that small business not only constitutes a very large segment of the entire business field, but makes special contributions of its own to the national economy. The tendency has been to consider the small business unit only in terms of the large, as in the case of the banker who said: "We must select the acorns that will grow into oaks." Small-unit enterprise, however, exists in its own right; it performs certain functions and services which are not duplicated by mass-production or standardized methods, are in some respects the reverse or complement of the latter, and are of distinct value in our national life.

Service to the Consumer.

The first of these contributions made by small business has already been suggested. It is the special service performed for the consumer. Thus, to a considerable extent, small business complements and rounds out the standardized production characteristics of the large mechanized establishments, and adds variety to the uniformity of service typical of large organizations. Small business is also responsible for much of the versatility of product and of service which, despite standardizing trends, is still deeply desired by the American consumer.

Contributions to Big Business.

There are also the contributions made by small business to big business itself. Within given industries, small units and large generally perform different productive functions or parts of functions. Accordingly, there exists between them an interdependence akin to a division of labor. It is frequently stated that the development of a new large industry brings many small business units into existence; it is less commonly recognized that the small ones perform functions

[31] See Appendix 1, table 5.

without which the large ones would find it difficult to exist. In manufacturing for example, the large central enterprises rely heavily upon the smaller independent units for secondary and tertiary processings, which translate bulk or semi-finished production into a wide variety of consumer goods. Much or most of the producing industry is dependent, in turn, for its contact with the consumer, upon the trade outlets and at times upon the repairing services, which, as far as numbers go, are prevailingly in small business hands.

A second type of inter-relationship between small business and large is presented by those instances in which the large, central industrial units receive the output of smaller ones, the latter having figured in preliminary stages of the productive process. This is most clearly illustrated by the pattern and parts concerns in the automotive industry, without which the assembly lines of the larger plants would not move. A variation of this interrelationship is presented by the small cannery or garment factory, the entire output of which is contracted for by the large mail-order house or chain-store.

Moreover, small business is an important customer of large business. This applies not only to the purchase of commodities for reprocessing or for inventory purposes, but also to the purchases of machinery, fixtures, vehicles, and the congeries of items which make up the capital equipment of the smaller units.

Competition with Big Business.

But there is still another aspect to the relationship. Although the existence of small business is necessary for the operation and the welfare of large, small business in many industries also competes with large. The course of invention (as in transportation) has provided small business with new and efficient small equipment which enables it to compete effectively with large business. The small independent enterpriser, furthermore is continually seeking opportunities to break into the business of large enterprise where the latter attempts to maintain high prices, or fails to perform some needed service.[32] Moreover, as has been frequently observed, the individual and small type of enterprise is regarded as the living expression of the open competitive economic system, traditional for this nation and embedded in our laws and customs.

An important corollary of the foregoing is the general effect of small business in maintaining the processes of individualism. The independent enterpriser has always been and continues to be of immense importance in the national psychology. The small businessman, together with the independent farmer and professional practitioner, has played an important role in fixing those standards of personal initiative, independent economic venturing, self-responsibility and self-determination in business, which are basic to the American way of life.

[32] But cf. the following: "There is a tendency to idealize the early nineteenth century and to assume that small business and the prices it charged were the result of competition. As far as I am able to see, there is little, if any, foundation for this. The village grocery store, the village blacksmith, the village grist mill, were all monopolies. Until the advent of the automobile, they charged conventional prices or administered prices which were not elastic. The people of the village could not go many miles to the next town. In a large measure this is still true in small towns. Such competition as there has been, curiously enough, came from large-scale enterprise; mail-order houses, and later the chain stores. The theory that prices were adjusted by competition under the old small-scale production in small towns, as far as I can see, simply never was generally true, despite some nostalgic reminiscences which are indulged in today." A. A. Berle, Jr., Memorandum of Suggestions: Investigation of Business Organization and Practices (July 12, 1938) (originally prepared for confidential circulation for members of the Temporary National Economic Committee), p. 2.

Contribution to Gainful Employment.

The final contribution of small business to our economy is by no means the least. It consists in the support of a considerable part of the population, as small-business proprietors and workers in small-business establishments. The smaller units of enterprise provide the livelihoods of a large share of the nation's gainfully employed population, principally because small enterprise is prevalent in fields where the ratio of machine production to the employment of manpower is relatively low.

In 1935, there were 2,292,184 active proprietors and firm members enumerated by the Census of Business, in trade, service, and the construction industry alone.[33] An additional number, not tabulated, included the active proprietors of small manufacturing, quarrying, and other business concerns. In view of these omissions and an apparent increase in the number of business units since 1935, the figure given above is probably an understatement of the number of proprietors and partners engaged in small business today. The great majority of these proprietors derived their livelihoods from the small business sector, though some were the owners of intermediate-sized establishments and a few, possibly, of large business concerns.

The total number of employing concerns, by size-groups based upon employment, has previously been stated (pp. —). The number of their employees may now be added. In March 1938 according to the Social Security Board, 3,916,574 workers were employed in establishments which had less than 10 employees, and 1,730,099 additional in establishments having from 10 to 19 employees.[34] These 5,646,673 workers constituted 25.2 percent of all the 22,373,417 employees included in the Social Security size-group tabulation.[35]

Adding these to the proprietors, an approximate minimum number of 7,938,857 persons supported by small business is obtained. This number represents 18.9 percent of the nation's estimated total of 42,019,000 persons gainfully employed in March 1938.[36]

Intermediate business begins at approximately the 20-employee level. The employees in all establishments having from 20 to 799 workers (roughly constituting the limits of intermediate business) added to the foregoing employees in the less-than-20-worker establishments, numbered 15,493,318, or 69.3 percent of all workers included in the Social Security tabulation. This number, including the proprietors, amounts to 40.8 percent of the nation's total of gainfully employed, supported by the small and intermediate business units.

The total number of employees in the large business establishments, understood as employing 800 workers or more, was but 6,880,099. This included executive staff members whose functions, in small business, would be largely performed by the active proprietors.

The number of livelihoods derived from active, direct participation in small business is greater than the number of livelihoods derived from direct employment in large business, if the active small-business proprietor be included in the contribution of small business to gainful

[33] Retail trade, 1,511,734; wholesale trade, 97,225; service, 615,032; construction, 69,193.

[34] See, Appendix 1, table 3. An additional 2,119,583 employees were not tabulated by size of employing establishment.

[35] If the 20–29 worker establishments be included as "small", then the total number of small-business employees rises to 6,723,314, or 30 percent of the workers under Social Security; again including these with the proprietors, the percentage of the Nation's gainfully employed persons deriving their living from establishments of less than 30 workers rises to 20.7 percent.

[36] Total of estimate of non-agricultural employment of Bureau of Labor Statistics, plus estimate of agricultural employment of the Committee of Economic Security (R. R. Nathan) both for March 1938.

employment. Excluding the proprietors, but including all employees enrolled under Social Security, the three main size-groups of employing concerns contributed to wage employment in 1938, respectively, as follows:

	Number of employing organizations	Percent	Number of employees	Percent	Payrolls	Percent
Small	[1] 1,674,237	92.5	5,648,673	25.2	$1,415,459,569	22.2
Intermediate	133,137	7.4	9,846,645	44.1	2,765,604,541	43.4
Large	2,445	0.1	6,880,099	30.7	2,194,868,301	34.4
Total	1,809,819	100.0	22,373,417	100.0	6,375,932,411	100.0

[1] Includes 122,890 establishments, with $59,276,132 taxable wages reported for the period January–March, 1938, which had no employees at the end of that period. Hence, the workers in these establishments do not appear in the column headed "Number of Employees."

In addition to the foregoing data, the figures from the Census of Manufacturers for 1937 show that small business employs a larger number of workers for each $100,000 of value added by manufacture than does large business.

The following table, which includes data for 166,794 manufacturing concerns, shows that the smallest units (those having from $5,000 up to $20,000 in value of product), employed almost twice as many workers per $100,000 of value added as did the largest.

Size by value of product:	*Number workers per $100,000 of value added*
Small:	
$5,000 to $19,999	49.5
$20,000 to $49,999	46.3
$50,000 to $99,999	43.8
$100,000 to $249,999	42.4
Combined small	44.1
Intermediate:	
$250,000 to $499,999	41.3
$500,000 to $999,999	39.8
$1,000,000 to $2,499,999	36.5
$2,500,000 to $4,999,999	31.4
Combined intermediate	36.7
Large:	
$5,000,000 to $24,999,999	26.7
$25,000,000 and over	26.0
Combined large	26.4

Moreover, the ratio of man-power employed to the value added declined steadily with each increase in the given size classifications of manufacturing establishments. The small business group as a whole, according to these figures, employed 44.1 workers for each $100,000 of value added as compared with 26.4 workers for the large group as a whole.

It is to be noted that important economic areas exist in which technology calls for a relatively high ratio of man-power to output and where the investment of capital per employee is small. The available data show that the average fixed investment in plant (capital assets) for each worker employed in the large type of factory is approximately $7,500; in the factory of intermediate size, approximately $2,300; and in the small factory, approximately $1,600.[37]

[37] See Appendix 1, tables 7 and 8.

THE FINANCIAL POSITION OF SMALL BUSINESS

The classic story of the small-business unit is that it was started "on a shoestring," grew from its own earnings, and has striven to accumulate sufficient capital to tide its operations over the production cycle and the collection-lag.

While most small concerns may have accumulated sufficient capital for their operating requirements, recent events have operated to frustrate the accumulation of sufficient capital to cover the collection-lag for a large number of small businesses. The most important of these events was the depression. A second development was a general rise in extensions of credit to customers. This latter development placed the small units in the position of either increasing the credit lines of its customers or forfeiting business to those of its competitors who could make such extensions.

Small business seldom has had sufficient financial resources with which to "bank" its customers. An indication of this lack may be seen in the income tax returns of the small business corporations which are probably better capitalized than the unincorporated units, for which comparable data are not available. For 1936, the 173,674 smallest business corporations—those with less than $50,000 in total assets—reported an average net deficit in the capital account of $4,322. For the entire group of 252,688 small business corporations with less than $250,000 in assets, the average net deficit in the capital account reported was $1,812. By comparison, the 35,263 intermediate corporations showed an average surplus and undivided profits, less deficit of $135,590, while the corresponding average figure for the 2,167 corporations in the large business category was $6,200,510.[38]

The compulsion to extend additional credit to customers, as well as other business exigencies, results in an increased debt burden. The 1936 Statistics of Income showed the average debt of the smallest business corporations to be $8,400, or 47 percent of their average total assets; and of all small business corporations to be $19,050, or 40 percent of their average total assets. The debt of the intermediate business corporations averaged $280,030, or 33 percent of their average total assets; while that of the large business units averaged $5,589,020, or only 23 percent of their average total assets.[39]

Further differences in debt structure between small and large business may be seen from an analysis of the data in the Statistics of Income for 1936. Debt is there subdivided into (1) "Notes and Accounts Payable," which in general represents short-term bank debt, trade debt, etc., and (2) "Bonded debt and mortgages," which represents long-term debt. These data show that 85 percent of the total reported indebtedness of the smallest business corporations was short-term while 15 percent was long-term. For all small business corporations, the respective percentages were 74 and 26 percent. By contrast, the figures for the intermediate and large business group was 54 percent for short-term debt and 46 percent for long-term debt.[40]

The heavy ratio of debt and the high cost of credit would appear to account, in part, for the smaller profit ratio of small business. Thus, in 1936 small business corporations showed a combined profit of 1.6

[38] Appendix 1, table 10.
[39] Appendix 1, table 9.
[40] Appendix 1, table 9.

percent on total assets, intermediate business corporations, 4.7 percent, and large business corporations, 6.0 percent.[41]

But despite this smaller profit ratio, the number of small business enterprises increased. In 1937, there was an increase of 46,663 small business enterprises over the preceding year, or, from 2,009,935 in 1936 to 2,056,598 in 1937. In 1939, the number increased by 45,402, or to 2,102,000.[42]

The resiliency of small business is further indicated by the fact that the number and percentage of small business corporations reporting net taxable income increased from 15.8 percent in 1932 to 44.3 percent in 1936.[43] This increase parallels that of intermediate and large business.

CAPITAL, CREDIT, AND SMALL BUSINESS

Summary of the Findings.

With respect to equity capital.—Small business by and large lacks adequate equity capital with which to finance its operations. In default of adequate equity capital, small business is compelled to rely largely upon mortgage and short-term credit. One reason for the inability of small business to obtain equity capital lies in the fact that it does not have the same access to the capital markets as does large business, since that machinery is adapted largely to the needs of big business.

One difficulty which must be taken into consideration in supplying equity capital to small business is its resistance to impairing its control or sharing its equity.

With respect to credit.—(*a*) Long term: Small business faces the same difficulties in obtaining long-term credit as it does in obtaining equity capital, since the existing credit facilities are not geared to deal with the special and peculiar needs of the smaller enterprise.

(*b*) Short term: Although short-term credit appears to be more available than either equity capital or long-term credit, nevertheless, small business experiences difficulties in obtaining short-term credit from the regular commercial banking sources. Short-term credit is, however, obtained through intermediary credit agencies, and from trade creditors, at charges which are frequently high and upon terms which tend to be onerous.

The difficulties experienced by small business in obtaining adequate financing result from two sets of circumstances: (1) the intrinsic operative characteristics of small business which have been previously noted; (2) the risk involved in individual transactions.

But the mere provision of adequate capital and credit will not in itself solve the small businessman's problems. He also requires the benefits which large business enjoys through its research and analytical services. Small business would profit immeasurably if it had the advantages of a systematic informational and research service expressly designed for its peculiar and distinctive needs and comparable to that furnished to the farmer by the Department of Agriculture, and to big business through its own laboratories and the Department of Commerce. Such an informational service could go far in introducing modern accounting methods and the wider application of business

[41] Appendix 1, table 10, but cf. Crum, Corporate Size and Earning Power (1939), ch. 23.
[42] Appendix 1, table 11. The number of establishments in 1939 was about 2,116,000.
[43] Appendix 1, table 14.

practices which have been commonly associated with the larger units of enterprise. Moreover, such an informational service might experiment with the development of new security techniques. In this connection, the experience of the agencies of the Farm Credit Administration in the organization of farm groups for the establishment of credit facilities should be looked into to determine whether these principles and methods are applicable to the financing of small business.

Sources of Equity Capital.

Individuals.—The major source of equity investments in small enterprise has always been (and still is) the moneyed individual who was familiar with the business, its management, and the locality in which it operated.

The financing of small enterprises has always presented difficulties since owners often have been more eager to expand than their resources would permit. Where their enterprises were successful, additional funds were provided from profits. The difficulties in financing usually arose when the business was only partially successful so that sufficient funds from profits were not available for expansion purposes. In such circumstances, the raising of local capital was not always possible, due to the uncertainties of the future of the enterprise.

The growing practice by individuals of placing their savings with savings banks, life insurance companies, building and loan associations, or the purchase of stock in the great corporations, has tended to siphon off into these institutions money which would otherwise have been used for investment in local enterprise. The growth of the chain store, the branch factory, and the centralization of business activity, has reduced a considerable part of local enterprise to the position of being a mere appendage of large business. The automobile dealer, the filling station operator, the dealer in electrical appliances, have become adjuncts to large scale manufacturing and distributing operations. The financing of these operations is provided by automobile finance companies, oil companies, building supply companies. The institutionalization of savings and the integration of a considerable part of local business into national organizations has created a void with respect to the financing of the remaining independent local enterprises. Moreover, a comment frequently made to the staff representatives during the course of the field study was that wealthy individuals were deterred from investing in local enterprises because of the tax situation and the desirability of tax exempt government bonds.[44]

The earlier activities of local wealthy individuals in supplying capital to local enterprise have continued but at a greatly diminished rate. In one city embraced by the field study a former banker maintained investments in numerous small enterprises.[45] To some extent group efforts appear to be replacing individual efforts in the supply of venture money. In some cities, community leaders have established community funds for the purpose of providing equity capital and

[44] See, for example, Hearings before Temporary National Economic Committee, Part IX, p. 3907: testimony of S. V. P. Quackenbush. For proposals with respect to "incentive taxation" which might remedy this situation, see Report of the Subcommittee of the Committee on Finance, U. S. Senate, 76th Cong., 1st sess. pursuant to S. Res. 215.

[45] See Appendix 2, p. —.

extending credit to local business.[46] In one city, a group of men, familiar with small enterprises through their own business and professional relations, organized a corporation for the express purpose of finding and selecting ventures in which the individual members of the group might make investments.[47] The experience of this group in supplying venture capital to small business has been unique in the contemporary financing of small business enterprises. The profit experience of the group, although not phenomenal, has, nevertheless, been such as to persuade the individual members of the possibilities of gain from organized and well directed activities in the financing of small business ventures.

Investment banking.—Investment banking has played virtually no part in the financing of small business. This is not surprising, since the underwriting and marketing of securities—the traditional business of investment banking—is geared almost exclusively to the requirements of large enterprise.

Even where efforts are made to specialize in the issues of small corporations, the experience of one investment banking firm shows that it did not underwrite the issue of any corporation having assets of less than $1,600,000.[48] Such concerns are not of course "small." That the small concern does not to any considerable extent employ the machinery of investment banking may be seen from the fact that during the period from September 1, 1934, to June 30, 1938, inclusive, only 353 issues of less than $100,000 (none, however, being less than $30,000) were registered with the Securities and Exchange Commission.

Since the overwhelming preponderance of small business is unincorporated, only a small sector at best can avail itself of the investment banking machinery. And even in this restricted area, there are limitations upon the effective utilization of investment banking facilities. One such limitation is the high cost of flotation.

The statistics of the Securities and Exchange Commission show that among registered issues with expected proceeds of less than $1,000,000, the cost of flotation amounts to around 20 percent of proceeds for common stocks, about 16 percent for preferred stocks, and about 7 percent for bonds.[49] Among the total costs of flotation, the compensation paid to underwriters and other distributors of securities looms large. For stock issues of less than $1,000,000 between 80 and 90 percent of the total flotation costs, and for bond issues of similar size, 70 percent of the flotation cost, have consisted of compensation paid for underwriting and distribution. Other expenses, which are not attributable to registration costs under the Securities Act of 1933, absorb a considerable portion of the remaining costs, as for example, listing fees, revenue stamps, State qualification fees, transfer agent and trustee fees. These fees must be paid irrespective of whether an issue is registered. Other expenses, such as legal and accounting fees and the expense of printing, are attributable only in part to registration.

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[46] The Chamber of Commerce of the United States, in a study entitled "Community Industrial Financing Plans," published in 1936 and reporting information received up to 1932, has described in some detail financing plans set up in various communities as a means of supplying capital to local industries. It lists plans in such cities as Akron, Ohio; Baltimore, Md.; Danville, Ill.; Fort Wayne, Ind.; Johnstown, Pa.; Louisville, Ky.; Lowell, Mass.; Omaha, Nebr.; Portland, Oreg.; Rochester, N. Y.; and Tulsa, Okla.

In the course of the field studies, a detailed inquiry was made of three community industrial funds—one at Scranton-Wilkes-Barre, Pa.; Omaha, Nebr.; and Portland, Oreg. They are discussed in the respective field studies dealing with these regions. See appendix 2, pp. 115-118; 136-137; and 161-162.

[47] See Appendix 3, sec. IV, p.

[48] See, Article, Ferdinand Eberstadt, Fortune Magazine (April 1939) p. 72.

[49] See Appendix 1, tables 15, 16, and 17.

While it is difficult to estimate precisely the additional cost of selling small issues which may be due to registration under the Securities Act, it is apparent that the extra cost is not in excess of about 1 percent of gross proceeds, and there is reason to believe that the extra cost is nearer one-half of 1 percent.[50]

The relatively small volume of unseasoned equity issues is due to the inability of such issues to find purchasers. An analysis of 700 small security registrations shows that 1 year after the effective date of the registration, over one-third had not sold any of the securities registered. In other words, over 200 such issues—fully registered and ready for market—could not find a single purchaser in the year following effective registration. This would appear to indicate that the "obstacles standing in the way of the successful flotation of issues of small and particularly of unseasoned enterprises are to be found in places other than the requirements of the Securities Act."[51]

As has been pointed out by Chairman Frank:[52]

> In reviewing the statistical and factual material which comes before it, the Commission has been particularly impressed by the fact that the flotation of small issues appears to have been a costly procedure at all times, and that the very great majority of those costs consists of the commissions and fees paid to underwriters and agents distributing these issues. The origin of the high cost of flotation of small issues thus obviously lies in the investment banking machinery itself. That machinery is geared mainly to the handling of larger issues. The minimum of expenses, be it ever so small, involved in the investigation and preparation of every individual issue and the difficulty of acquainting prospective purchasers with the security offering of a company which may not be known to the investing public, combined, force the security distributor to charge a commission on small issues which is very high in proportion to the proceeds. This emphasis on the high cost of investment bankers' services in distributing small issues should not be taken as a criticism of the investment bankers, but merely as a statement of conditions which have prevailed for a great many years, and which, unfortunately, are often lost sight of, when the obstacles of the flotation of small issues are discussed.

Investment trusts.—The investment trust or company with its semimobile source of capital presents important possibilities as one solution to the problem of providing equity capital to intermediate-size business;[53] however, it has seldom been used for that purpose.[54] The prevailing practice of diversification has been for a trust to take small parts of the capital of many large enterprises, rather than large parts of the capital of many small enterprises. As presently constituted,

[50] See, for example, 86 Cong. Rec. p. 7093 (Apr. 17, 1940) communication from Chairman Jerome N. Frank to Congressman John W. McCormack: "In our desire to determine as closely as possible the reasons for high cost of flotation of small issues, we have recently had our Research and Statistics Section make a comparison between the costs of flotation of small issues in the years 1935–38, when the Securities Act was in effect, and in the years 1925–29 * * *. Our statisticians have found that the total cost of flotation of bond issues of less than $1,000,000 averaged about 7 percent of gross proceeds for both periods, but that it rose for preferred, stock issues from about 8 percent to nearly 15 percent. It is, however, mainly the expenses other than compensation to underwriters and distributors which interest us here. These other expenses rose only from 1 to 2 percent for bonds and from 0.8 to 1.8 percent for preferred stocks. Thus the average increase is less than 1 percent of total proceeds, and only part of that increase is attributable to registration under the Securities Act. We were unable to collect sufficient material on small issues of common stock to form precise estimates, but there is no reason to assume that the increase in expenses which may be caused by registration under the Securities Act is larger than in the case of small issues of preferred stocks and bonds." See also, Cost of Flotation for Small Issues, Report by Research and Statistics Section of the Trading and Exchange Division to the Securities and Exchange Commission, 1940.

[51] Id., p. 7094. See also, Selected Statistics on Securities and on Exchange Markets, report to the Securities and Exchange Commission by the Research and Statistics Section of the Trading and Exchange Division, 1939, pp. 34–37.

[52] Ibid., p. 7094.

[53] See Investment Trusts and Investment Companies, reports of the Securities and Exchange Commission. See also, Securities and Exchange Commission Release No. 2446 (March 18, 1940) relative to the Regulation of "Pegging, Fixing and Stabilizing" of Security Prices.

[54] The English experience in financing small business enterprises has not been dissimilar to our own. See report, Committee on Finance and Industry (1931) pp. 173–174. But Cf. Grant, A Study of the Capital Market in Post War Britain (1937), for attempts to meet the deficiencies described by Lord McMillan's Committee.

the investment trust offers little promise as a financing medium to the small enterprise.

A few investment trusts have been organized with the express purpose of purchasing the equities of intermediate size enterprises. One such investment trust, which has devoted a portion of its fund to a varied list of "special situations," considered 345 prospects during a 2-year period, and made investments in 13, the investments ranging from $19,900 to $2,500,000, the average investment being approximately $755,000.[55] At the end of 1939, this company had invested in 20 situations in intermediate size enterprises, having considered 206 additional applications during this year. Since the smallest investment made by this trust during the period 1936–39 was $100,000, it is readily apparent that *small* enterprises were outside the scope of its activity.[56]

Whether some form of investment trust will be able to serve as an effective pipeline to connect idle funds with the *small* business sector depends in no small measure upon the adoption of those specialized techniques of small business financing which have been successfully developed by the intermediate credit agencies.[57]

Sources of Credit.

The commercial banks.—Traditionally, the commercial bank has been a major source of credit for local enterprise. The local bank was completely integrated into the life of its community; its management and ownership were in local hands; the business potentialities of its borrowers were known intimately. Frequently, the directors and principal stockholders were also themselves financially interested in local ventures.[58]

The type of credit which the local bank extended was customarily based on two kinds of collateral security: (1) short-term promissory notes; (2) short-term mortgages on real property. But occasionally the small corporation also borrowed on the strength of its own securities. In many cases, it was the custom for the local moneyed citizens, who themselves were interested in an enterprise, to endorse the paper of the borrowers. Over periods of relative economic stability this method of credit extension was, on the whole, adequate in supplying the needs of that sector of small business which enjoyed normal banking relations.

With the advent of the depression of the 30's and the resulting credit strain upon the local banking system, this procedure broke down.[59] Many local banks were seriously weakened. They found

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[55] See, Appendix 3, III, p. — for a more detailed discussion of the activities of this trust.

[56] Loans to small business enterprises by insurance companies do not appear to offer great promise as an effective medium of financial aid to such enterprises. At a hearing before the Temporary National Economic Committee, Mr. John Stedman, vice president of the Prudential Insurance Co., testified that, with regard to industrial loans, "we didn't want to go much below one hundred thousand, possibly fifty, and considered small industrial loans to be limited by the figure of a million dollars," and that the company had made only 2 loans out of 120 applications. Most of the applicants, he stated, were in need of "venture capital," a type of loan in which the company as trustee for its policy holders did not believe itself justified in engaging. Verbatim record of the proceedings of the Temporary National Economic Committee, February 27, 1940, pp. 126–127. Mr. F. W. Ecker, vice president of the Metropolitan Life Insurance Co., testified that his company had made only 6 loans under $1,000,000 to "small" business enterprises—2 being below $500,000 and 4 being between $900,000 and $1,000,000. There were 8 loans between $1,000,000 and $1,500,000. (Id. pp. 144–145.)

Both witnesses testified that their companies have not as yet developed any systematic machinery for servicing loans to small business in order to minimize the otherwise large expense factor.

[57] *Cf.* discussion with respect to finance companies, factors and accounts financing companies, pp. — *infra.*

[58] For much of the analysis in this section we are indebted to an unpublished report on "Medium Term credit in the United States," prepared for the League of Nations in 1936 by Prof. Winfield W. Riefler of the Institute for Advanced Study.

[59] See, however, Appendix 2, VI, p. — for the effect of branch banking upon local credit relationships.

that their local loans were unsuited either for hypothecation or realization. Potential outside lenders, being unfamiliar with local conditions, were generally unable to evaluate the worth of local loans. Moreover, realization on such loans became difficult, if not impossible, since their value was dependent primarily upon the continuance of the borrowers as going concerns. In the case of mortgages on small industrial enterprises, the special purpose value of the underlying physical assets created difficulties; and in the case of pledged securities of local concerns, there was no marketability.

The post-depression situation with respect to short-term loans continued to present grave problems to the local bank and the small businessman. Banks which were in straitened circumstances were either unwilling to make such loans or reluctant to renew them as formerly. Closed banks could of course do nothing but call for the prompt repayment of loans outstanding. In general, the pressure which was exerted for prompt repayment resulted in hardships to the borrower.

During recent years, an additional factor has been present which has had a serious effect upon small business: the breakdown in the nexus of local financing relationships upon which the successful extension of bank credit to local borrowers frequently rested.

By and large, the small business enterprise is not in a position to meet the existing lending standards of commercial banks. As a good risk, it would seem preferable that the enterprise should be expanding. But if the enterprise is expanding, the likelihood is great that it will be short of capital and the equity in the enterprise will be thin. In all probability, tangible assets are likely to be special purpose plant and equipment of negligible value on an auction basis.

In reality, the basis of the credit in such instances is determined by the personal standing of the owner or owners of the business and the lender's judgment of its future prospects as well as of the quality of its management.[60] The growth in the average size of the commercial bank, the spread of branch banking, and the closing of the doors of thousands of small unit banks, has resulted in a situation where bank officials no longer have the same intimate knowledge of local management and enterprise as formerly. The local businessmen, who formerly either owned or managed the local banks, have been to an increasing extent supplanted by a banking personnel which has risen from the ranks. This newer type of manager is disposed to pay greater attention to the static elements of assets and liquidity than to the dynamics of growth and expansion.

Prior to the depression, when the local banks were generally owned and managed by the substantial citizens of the community, it was not unusual for the bank to have among its own stockholders the responsible backers of those local enterprises which enjoyed bank credit. The ultimate cushion of risk for the bank as well as for the enterprise to a considerable extent, therefore, rested upon the same individuals. During the crisis, this cushion of risk became seriously impaired, since

[60] For a list of 18 reasons given by banks for refusal of loans, see Report on the Availability of Bank Credit in the Seventh Federal Reserve District, submitted to the Secretary of the Treasury by Charles O. Hardy and Jacob Viner. The list, with the numbers of rejections for each cause, follows (p. 10 of Report): 1. Loan policy of bank (87). 2. Earnings (344). 3. Inadequate working capital (658). 4. Inadequate net worth (720). 5. Unsatisfactory customer relationship (224). 6. Speculative or promotional (172). 7. Character of business (45). 8. Indebtedness to closed banks (44). 9. Past insolvency (102). 10. Character of management (259). 11. Loan too slow (349). 12. Real estate (33). 13. Not customer of bank (109). 14. Cause unknown (39). 15. Examiner criticism (145). 16. Collateral unsatisfactory (288). 17. Loan to transfer indebtedness (20). 18. Other reasons (65).

many local bank stockholders and directors were compelled to draw heavily on their own resources to make good assessments on their bank stock in the effort to maintain the solvency of their banks and to make good on the double liability which may been attached to their stock. The losses sustained by these individuals were frequently of such magnitude as to impair their endorsement on the paper of those local enterprises in which they had previously been associated. To no small extent, the banking crisis served to undermine the financial standing of those groups upon whose credit loans had formerly been made. Thus, local enterprises which formerly had constituted good risks were seriously affected. And those enterprises which had never enjoyed satisfactory banking relations found it even more difficult to establish them.

While many local banks have returned to their traditional lending practices, or have endeavored to meet the problem through the establishment of personal loan departments, and the Government through the Reconstruction Finance Corporation and the Federal Reserve Banks,[61] has also attempted to alleviate the situation, the void has not been filled completely either for those who formerly had established banking relations or for those who have been unable to establish such relations.

Today, as in the past, the difficulty of obtaining medium term loans, i. e., those running from 1 to 5 years, remains a pressing problem. In the past, this type of credit was obtained by mortgaging the business and the home, or through the transformation of essentially short term loans into long term credit by automatic renewals. The depression experience of the banks which formerly engaged in such transactions has been so unfortunate as to confine renewals to periods of 1 year or less.

This concatenation of events has made for credit stringency of such a kind that small businessmen encountered in the field studies quite commonly epitomized their situation by saying: "If your business is in shape to get a bank loan, it doesn't need one." On the other hand, bankers almost universally challenged this sentiment by observing that: "No creditworthy business is ever refused credit." Both views contain a modicum of truth, since the question is, essentially, one of definition: "What is a creditworthy business?"

It must be recognized that commercial banks do not act wholly without justification in restricting credit to small business. The position adopted by the banker that the funds at his disposal belong not to him but to his depositors, and therefore can be loaned only to individuals and enterprises whose assets and future prospects make repayment certain, is fundamental to sound banking practice. Under this responsibility, the business prospects of a considerable proportion of the smaller enterprises at any given time is not such as to warrant bank credit. One may perhaps criticize the lending policy of the commercial banker in not giving sufficient consideration to the individual business cycle of his borrowers,[62] but one cannot require the commercial banker to lend his resources indiscriminately and irrespective of the financial position and future prospects of loan applicants. While a considerable number of loan applicants may not be able to satisfy the existing

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[61] The activity of these agencies is discussed infra, pp. —.

[62] See, in this connection, Hearings before the Temporary National Economic Committee, Part IX, p. 3896: testimony of Ernest Jerome Hopkins.

standards of commercial banking, it does not follow that such applicants and their enterprises are not creditworthy. For such enterprises frequently do obtain credit from *extra* banking sources and are able successfully to retire their obligations.

The available statistics on commercial loans do not clearly reflect the inability of small enterprise to obtain commercial bank credit. In the communities studied, the commercial loans and discounts of small enterprises ranged between 25 and 40 percent of deposits. However, a considerable (and apparently increasing) portion of such loans were not credits extended to business directly, but were credits extended to finance companies and commercial factors. Commercial banking thus appears to have abdicated a part of its function to the latter. Moreover, the commercial banks appear to be increasingly satisfied with the "wholesaling" of credit, leaving the extension of direct credit to the "retailing" finance companies and factors.

Those enterprises which now have adequate banking relations are the successful ones which have always experienced satisfactory banking relations. It is to this group of small business enterprises to which the banker usually refers when he observes that no creditworthy applicant is being refused. *But the heart of the problem has been and continues to be that large group of small businessmen whose enterprises are not so firmly established and whose personal resources are not so great as to be able to satisfy the existing standards of commercial banking.* While this group does not and cannot obtain bank credit under existing banking practices, it does obtain credit from the intermediate financing agencies as well as from private lenders and "loan sharks." The success of the lending activities of the intermediate agencies and the flourishing business enjoyed by "loan sharks" suggests that credit can be successfully extended to this group if an appropriate credit machinery is utilized.

Some of the major reasons for the inability of commercial banks to extend credit to small business are:

1. *High cost of making small loans.*—The costs of investigating and "servicing" small loans is not directly proportionate to the size of the loan. Therefore, interest rates which may be adequate for larger loans are not necessarily adequate for smaller loans. In this connection, consideration might well be given to the establishment of zones of risk for commercial credit, with different rates applicable to each zone. In practice, this would entail a separation of interest charges from cost and loss charges, the latter being treated as a separate cost.

2. *Lack of a systematized procedure for handling small-business credits.*—The making of small business loans requires special skill and facilities. Since the success of the small enterprise is so closely associated with the management qualities of its owner, the extension of small business credits lies in a zone between the banking standards applicable to business enterprise generally and the personal loan. While the small business credit does not fall precisely within the standards used in either of these fields, it requires a technique which combines elements of both. Furthermore, the successful financing of small business by commercial banks necessitates loans to a large variety of unrelated enterprises and many different loans in each classification. In the absence of such diversification of risk, the bank's solvency becomes too exclusively dependent upon the vagaries of business activity in a restricted field. As presently operated, most

commercial banks lack the special skill and the facilities for supervision necessary in handling small business credits.

3. *The growth of intermediary financial institutions financed largely by the commercial banks.*—The commercial banks, on the whole, do not appear to be concerned seriously with the competition offered by the personal loan company, the accounts finance company, the factor and other intermediary financial institutions in preempting the financing of small business. The phenomenal growth of these institutions has been due largely to their ability to specialize in certain types of risk and to obtain the supervision over a large area of small loans which is essential to successful lending in this field. In fact, by financing the intermediary institutions, the commercial bank is able indirectly to engage in profitable operations without directly assuming the risk, expense and responsibility incident to handling an enormous number of unrelated and widely scattered transactions. Accordingly, the banks through this indirect financing have been able to obtain the diversification of risk which they have been unable to obtain directly.

4. *The need for liquidity operates against medium and long-term commitments.*—During the course of the field study, numerous instances were observed of loans rejected not from any lack of creditworthiness, but rather because of the credit period involved. That banks should have rejected such loans at a time when excess reserves were at or near an all time peak and commercial loans were relatively more scarce than at any time in recent banking history, suggests that the commercial banks have not yet recovered from their bitter experience with the crisis. It must also be recognized that under our system of banking, the commercial bank should not be expected to supply the need for equity capital. In making long or intermediate term loans, a bank must consider not only the non-liquid and unmarketable character of the assets which it will have to hold, but also the additional element of risk which is involved as, for example, an adverse turn in the business cycle, or changes in the management or a new development in technology which may wipe out the borrower's enterprise.[63]

Federal credit agencies.—Since 1932 the Federal Government has created a series of credit agencies designed to narrow the gap in credit facilities. Among such agencies may be mentioned the Federal Housing Administration. which insures bank loans for the repair and renovation of residential dwellings; the Federal Reserve banks, which make industrial loans for periods up to 5 years in cooperation with banks and directly; the Reconstruction Finance Corporation, which also makes industrial loans either directly or in participation with banks.

1. *Federal Housing Administration.*—By the end of December 1938, the F. H. A. had insured a total of 1,833,185 loans for repair and renovation purposes under title I of its act, amounting to $733,350,548. Claims paid on loans in default total $19,239,537; but recoveries under such loans amounted to $6,232,843. It should be noted, however, that all the assets acquired in connection with defaulted loans have not been realized.[64]

[67] See, in this connection, W. Thomas, The Banks and Idle Money, Federal Reserve Bulletin (March 1940), p. 199.

[64] See report of the Federal Housing Administration for the year ending December 31, 1938, p. 148.

2. *Federal Reserve banks.*—The Federal Reserve banks up to February 21, 1940, have received 9,452 applications for loans aggregating $406,845,000. The loan applications granted were 2,802, aggregating $189,472,000.

A classification of the loans made by size between June 14, 1934, and December 29, 1937, shows that 221 of the loans were for less than $2,500 each; 343 were for loans from $2,501 to $5,000; 335 were for loans from $5,001 to $10,000; 1,289 were for loans from $10,001 to $100,000; 243 were for loans from $100,001 to $400,000; and 40 were over $400,000.

The foregoing data shows that 899 out of 2,406 loans made were for less than $10,000—the category which would more nearly embrace the small enterprise. Classification of these same loans by amount shows that the 221 borrowers taking $2,500 or less received a total of $354,000; the 343 borrowers taking between $2,501 and $5,000 received $1,449,000; the 335 borrowers receiving between $5,001 and $10,000 received $2,900,000. These three groups totalling 899 borrowers, which would more nearly embody small business, received a total of $4,703,000.

The gross earnings on the $67,120,320 of industrial advances (no break-down by size of loan is available) made by the Federal Reserve banks under section 13b of the Federal Reserve Act to December 31, 1939, were $6,821,395. Expenses, exclusive of losses and reserves, for these loans amounted to $3,671,988. Losses charged off amounted to $560,780 and reserves set up to cover anticipated losses total $2,041,529.[65]

3. *Reconstruction Finance Corporation.*—The R. F. C. up to February 29, 1940, had received 15,501 applications for loans aggregating $1,285,846,000 under section 5 (d) of the Reconstruction Finance Corporation Act. The loans granted and commitments outstanding as of February 29, 1940, were 9,164 aggregating $575,559,000.

A classification of the loans disbursed by size as of February 29, 1940, shows that 2,462 of the loans were for less than $5,000; 874 were loans from $5,001 to $10,000; 1,095 were loans from $10,001 to $25,000; 605 were loans from $25,001 to $50,000; 502 were loans from $50,001 to $100,000; 282 were loans from $100,001 to $200,000; 193 were loans from $200,001 to $500,000; 44 were loans from $500,001 to $1,000,000; and there were 26 loans for over $1,000,000.

The foregoing data show that there were 3,336 loans disbursed out of a total of 6,083 under $10,000—the category which would more nearly embrace the small enterprise. This group of borrowers received a total of $12,027,428 or 4.1 percent of the total loans disbursed. Data on the loss experience of the R. F. C. comparable to that of the Federal Reserve banks are not available.[66]

The accounts financing companies.—It has been stated that accounts-receivable finance companies began to purchase retail receivables as early as 1904.[67] By 1909, the Commercial Investment Trust Corporation had begun to finance piano dealers' receivables. By 1916, at least a dozen companies were engaged in purchasing installment contracts arising from the retail sale of pianos and automobiles.[68] Later, manufacturers of carriages, stoves, furnaces, plumbing equip-

[65] Tables 18, 19, and 20, appendix 1, pp. 86–88.
[66] For a more detailed analysis, see appendix 1, pp. 89 et seq.
[67] E. R. A. Seligman: I. The Economics of Installment Selling (1927), pp. 35–58.
[68] R. Nugent: Consumer Credit and Economic Stability (1939), p. 80.

ment and washing machines also entered the field of financing receivables. But it remained for the growth and development of the automobile industry to give intermediary financing a significant position in consumer credit. "Automobile dealers, recruited from the ranks of bicycle and carriage dealers, mechanics, and blacksmiths had little capital to meet the requirements of increasing credit sales, and manufacturers, using their funds for plant expansion, required cash payment for deliveries to dealers. Banks were extremely wary of loans secured by a commodity whose location could be shifted so readily and they looked askance at long-term credits for the purchase of such luxuries." [69]

During the 1920's with the development of the electric refrigerator, new heating apparatus, the radio and similar appliances, the accounts-receivable finance companies greatly extended their area of operations. Today, such companies finance the purchase of virtually every type of consumer durable goods, and are now entering the field of nondurable goods. There still remains, however, a considerable area of customer accounts which they do not finance.

The growth of the accounts finance companies is a phenomenon of our times. At the close of 1923, intermediary financing agencies held receivables of $356,000,000, largely automobile paper; at the end of 1929, the amount held had increased to $1,373,000,000. There was a decline to $548,000,000 by the end of 1932, but by 1937 the amount of receivables had swelled to $2,173,000,000.[70]

The finance companies raise their capital in part through the sale of their own securities—common stocks, bonds, and debentures—and through bank loans secured by investment paper. For example, one medium-sized finance company with an authorized capitalization of $1,000,000, had receivables on hand of $1,637,624, and had issued 6 months' notes, largely taken by banks, secured by receivables, in the amount of $1,105,000. The notes outstanding amounted to approximately 67.5 percent of the receivables held.[71] A large finance company with $290,000,000 of receivables at the end of 1938 had short-term notes outstanding in the amount of $105,970,000, or 36.4 percent of receivables on hand. This company has had as much as $300,000,000 of notes outstanding with 300 banks.[72]

The financing of receivables by special companies established for that purpose has become a significant factor in the financing of small business. These companies purchase certain customer accounts of their clients. Unlike installment credit, the customer is generally unaware of the fact that his account has been acquired by a finance company and that in reality his debt has been transferred. Repayments by the customer are forwarded to the finance company. The terms incident to the transaction both with respect to interest charged and the percentage advanced on receivables vary widely. The success of the finance companies in dealing with their customers has been due largely to their ability to assess accurately the peculiar financial

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[69] Ibid. at 80.

[70] See Appendix 1, table 12, p. —. For additional studies of consumer financing, see the reports of The National Bureau of Economic Research, viz: R. A. Young, Personal Finance Companies and Their Credit Practices; W. C. Plummer and R. A. Young, Sales Finance Companies and Their Credit Practices; R. J. Saulnier, Industrial Banking Companies as Agencies of Consumer Installment Credit; J. M. Chapman Commercial Banks as Agencies of Consumer Installment Credit; J. D. Coppock, Government Agencies of Consumer Installment Credit.

[71] See Appendix 3, I, p. — for a more complete discussion.

[72] See Appendix 3, II, p. — for a more complete discussion.

risk of each particular type of receivable and to adjust charges to the conditions of each particular business.

While discount rates and attendant terms vary, most transactions follow an accepted pattern. The amounts paid in cash by the finance company range from 60 to 80 percent of the face value of the accounts assigned. Amounts paid by the customers on the receivables in excess of the amounts advanced by the finance company are retained by the latter. From this excess, deductions are made for losses on the uncollectible accounts, interest, service charges, additional interest on unpaid accounts, bonding fees, flat annual charges, fees for "business advice," et cetera. Any sum remaining after the foregoing deductions have been made is retained by the finance company for the account of the client.

It is difficult to ascertain what the total accommodation will cost the client. Businessmen interviewed in the course of the field study stated that their over-all costs for the money obtained ran as low as 10.5 percent, more commonly from 14 to 22 percent, and as high as 35 to 40 percent of the face value of the assigned accounts.

While the costs, expenses, and charges of the finance companies are a reduction in the potential profits of the client, the cash provided by the finance company, nevertheless, permits the client to obtain trade discounts in his business, to make special purchases, and to carry on business activities on a scale which might not otherwise be possible.

The technique of financing small business, as developed by the finance company, demonstrates the feasibility of successfully providing credit to businesses whose creditworthiness is not up to the standards and practices of commercial banking. The process of aggregating many risks and of fixing interest rates and service charges in accordance with the peculiar needs and circumstances of special types of business and particular clients, makes it possible to carry on successful operations in an area largely abandoned by the orthodox commercial banker.

The factor.—Factoring is carried on, in its traditional form, by some 25 firms located primarily in New York City and a few other financial centers.[73] Most of these firms have been long established. The history of factoring goes back to the English woolen-cloth industry. It was at Blackwell Hall—for centuries the center of the English woolen trade—that factoring had its origin. The Blackwell Hall factor performed largely the same function which the nineteenth century, dry-goods commission merchant did in the United States. Each received, stored and sold the merchandise which was consigned to them by the mills. Each made advances on the security of such merchandise. When the merchandise was sold on terms of from 1 to 6 months, or longer, each made cash advances against the obligation of the buyer. Each advised the mill of the buyer's financial responsibility and each warranted such responsibility for a cash consideration.

The commercial factor was primarily a merchant; he performed certain recognized functions for manufacturers and other merchants. Today, the merchandising function of the factor is virtually non-existent; his financial function is now primary. His principal business now is the purchasing of open accounts, usually without recourse. That is to say, the traditional factor assumes the full credit risk of the accounts which he accepts. He provides each of his clients with a revolving fund, which becomes a permanent part of their liquid

[73] See hearings before the Temporary National Economic Committee, pt. IX, pp. 3993–4005; testimony of William Hurd Hillyer.

capital. He does this by purchasing their selected open accounts as rapidly as they are created. In some cases, he makes advances upon merchandise, although this practice is falling into disuse. Within recent years, factoring has extended to such diverse fields as fuels, furs, shoes, paper, rubber goods, glassware, metal products, lumber, furniture.[74] The annual business of the principal factors increased during the period 1928 to 1933 from $340,000,000 to $542,000,000 and now exceeds $700,000,000.

Factoring, as a form of accounts financing, is distinguished from the finance-company operation by the positive control exercised by the factor over the credit sales of his client. Under this arrangement, the factor, in advance of a proposed sale on credit by the client to his customer, authorizes or declines to authorize the proposed extension of credit.

In traditional factoring, the receivables which are accepted by the factor are purchased without recourse. That is to say, the factor may look only to the customer for repayment. The client assumes no responsibility in the event of the customer's nonpayment. The factor, therefore, must be intimately aware of the creditworth of those customers whose paper he purchases. The largest factors have, therefore, instituted elaborate systems for rating the credit of their clients' prospective customers.

All factoring, however, is not done in this fashion. Many concerns which describe their business as "factoring" are, in reality, carrying on their business in the manner of the installment finance companies. There is a large marginal area in factoring, in which both guarantees and "recourse" still prevail. The practice of the "double guaranty" is apparently increasing as factoring is extended into new fields.

The factor, like the finance company, is essentially an intermediary banker. Factoring concerns are large users of commercial bank credit. Recently, a few factors have had indirect recourse to the capital markets through their affiliation with the larger finance companies. The credit rating of the factor is predicated upon: (*a*) his reputation and financial resources; (*b*) the resources and reputation of his clients where paper is sold with recourse; and (*c*) the element of safety resulting from the aggregation of the paper of many different risks.

One general effect of factoring is to shorten the periods during which credit is outstanding. This results largely from the practice of the factor in charging a flat fee for the factoring service. This fee usually ranges from 1 to 2 percent on the receivables purchased by the factor. A 1-percent fee with a turn-over of 30 days will net the factor 12 percent annually on the average turn-over. But a 1-percent fee with a 15-day turnover will net the factor 24 percent. Therefore, it is to the advantage of the factor to reduce the credit period. While this shortening of the credit period may be of ultimate benefit to the client, a too-abrupt shortening of the credit period may drive customers away. In the course of the field studies, a case was observed where the sales volume had shrunk from $1,000,000 to $300,000 as a

[74] Although the finance company has been of more recent origin than the factor, it is not without interest that two of the largest American finance companies have recently entered the factoring field. The Commercial Credit Corporation now owns two factoring concerns—Textile Banking Co and Edmund Wright Ginsberg Corporation. Commercial Investment Trust, through its factoring subsidiary, Commercial Factors, owns the old established houses of Frederick Vietor & Achelis, Peierls Buhler & Co., and Schefer, Schramm & Vogel, together with L. Ernstein & Bro., Inc. It also owns Meinhard, Greeff & Co. and William Iselin & Co., Inc., the last being one of the oldest and largest firms in the business. Hearings before the Temporary National Economic Committee, Part IX, p. 3996; testimony of William Hurd Hillyer.

result of the imposition of a 30-day collection period on a business accustomed to a longer period.

Since the factor functions as the credit department, so to speak, for his client's business, he exercises a much more intimate control over the business than does the finance company. In the language of the trade, a client is referred to as being "in the hands of" its factor. This condition is the result of the factor having become an integral part of the client's business. Thus factoring has come to be regarded by some as "an unmitigated evil," and by others as an important influence for stability and prosperity.

Since the factor determines whether or not he will accept the credit extended by the client in any particular case, he will authorize credit only to the cream of the accounts; the client must decide whether to finance the more marginal accounts himself and assume the resultant risks. The client is, therefore, placed in the dilemma of rejecting the orders of unauthorized accounts and suffering losses in business volume, or filling such orders and assuming the full risk himself. Factors naturally discourage the latter practice and their contracts often limit the proportion of credit sales which the client may make at his own risk.

The factor charges, by standard practice, 6 percent interest on the initial cash advances paid to the client on assigned receivables, and pays 6 percent interest on client's surplus collections held on deposit.

An evil present in both factoring and finance-company practice is the secret assignment of accounts receivable. In such cases the customer continues to remit to the business from which the goods were ordered, and does not know that the recipient merely countersigns the checks and turns them over to the accounts-financing agency. Other creditors of the business are unprotected. While the secret assignment of accounts is not everywhere legal, it is a frequent practice where state laws do not expressly prohibit it.

To summarize the situation with respect to finance companies, factors, and accounts financing companies:

1. These "retailers" of credit attract equity capital and are able to tap the credit of banks and the capital market because of their ability to organize the multiplicity of small transactions into aggregates, and to graduate financing charges and terms to the specific requirements of each individual industry and client.

2. These "retailers" of credit are special-purpose concerns, equipped to appraise particular types of risk and to apply the most advanced techniques of risk-appraisal and accounting.

3. To an increasing extent, small business is obtaining its credit from these "retailers" of credit. The cost of such credit is considerably in excess of the cost of bank credit. The small business concern which must utilize this medium of credit is placed at a disadvantage in relation to those of its competitors who are able to tap bank credit and the capital markets. The latter are commonly the intermediate size and large concerns.

4. Since this field of credit extension is largely unregulated, except insofar as competition is a regulating influence, practices vary widely and many types of abuses exist.

The trade credit.—The trade credit is the oldest form of credit available to business.[75] It has continued to be the mainstay for the smaller

[75] See Nugent, op. cit. supra, ch. II.

business enterprises. A sample analysis of the credit of 40 small businesses of various sizes and types showed that trade credits constituted 65 percent of the total payables; other nonbank credit, 24 percent; and bank credit, 11 percent.[76] An indication of the magnitude of trade credit may be seen from the Statistics of Income.[77] Although the data refer only to incorporated enterprises, the aggregate amount of notes and accounts receivable for all nonfinancial corporations at the close of 1937 was $15,700,000,000. It may be interesting to compare this figure with the volume of outstanding commercial loans as of the same date, which was $7,400,000,000.

Trade credits include not only credits arising from commodities purchased for resale, but also credits arising from the purchase of machinery, equipment, fixtures, et cetera, purchased on long term. While the credits arising from commodities purchased for resale are the preponderant type of trade credit, the long-term type of credit is assuming a considerable proportion of all trade credit. The short-term variety of trade credit, in reality, provides current operating requirements. The long-term variety of trade credit is a form of capital extension.

The use of the trade credit as a method of financing business enterprise presents three basic problems: (*a*) the adequacy of the credit (*b*) the control over the customer which the extension of such credit makes possible; and (*c*) the influence of the business cycle on both the expansion and contraction of the volume of credit made available by the creditor.

The weaker the capital position of the enterprise, the greater is the reliance upon the trade credit. The stronger enterprises having access to bank credit can achieve a relative independence from their trade suppliers through their ability to pay cash, and are, therefore, in a position to bargain for price and terms other than credit extension. The weaker enterprises, barred from access to bank credit, are forced to use their purchasing power to bargain for credit. These enterprises are, therefore, unable to "shop around" for price advantages, but must purchase where credit is made available. Thus not only is this type of enterprise forced to pay higher rates for its borrowings, but it must also sacrifice its freedom of action in order to obtain needed funds. Since even under the most favorable circumstances no single trade creditor or group of creditors is willing to extend credit to the full amount of the capital requirements of an enterprise—and this is particularly true of the weaker units—the trade credit is inadequate to cover all requirements. Therefore, recourse must be had by the weaker units to other credit sources, or else forfeit their independence.

During the course of the field study it was noted that small business enterprises, which were dependent heavily upon trade credit and were unable to avail themselves of opportunities to canvass competitive establishments, were at a signal disadvantage with those of their competitors whose financial resources did not bind them to any single trade supplier or group of suppliers. The business enterprises which are largely dependent upon trade credit were found to exist virtually on the sufferance of their creditors. Heavily indebted to their suppliers, such enterprises have become to all intents and purposes mere

[76] See Appendix 2, I, p. —; see also Hearings Before the Temporary National Economic Committee, pt. IX, pp. 3894–3895, and exhibit No. 629, testimony of E. J. Hopkins.
[77] U. S. Treasury Statistics of Income for 1937, Part 2, as published in press release of October 25, 1939.

appendages of the larger organizations and cease to be free and independent entrepreneurs.[78]

Dependence upon trade credit places the individual enterprise at the mercy of those fluctuations in business "confidence" which periodically sweep over the economic scene. The dependent enterprise is faced with demands by its suppliers for immediate repayment of outstanding accounts and simultaneously finds its supply of credit cut off. This compels the weaker enterprises to throw their stocks upon the markets at sacrifice prices in order to satisfy the demands of the trade creditors. On the upswing of the business cycle, the weaker enterprises are apt to be tempted by the abundance of trade credit to expand excessively and to accumulate considerable quantities of merchandise subject to payment on demand. These expansions and contractions of inventory are often without regard to the actual needs or financial position of the smaller enterprise and all too frequently have led the smaller units to the graveyards of bankruptcy.

Other sources of business credit.—In addition to the sources of credit previously discussed, small business has resorted to the personal-loan company, the personal-loan departments of banks, and to private lenders. Numerous examples of this type of borrowing were encountered in the course of the field study. While these lenders are ostensibly in the business of extending credit for household and personal needs, their facilities are being used increasingly to provide small amounts of credit to those enterprises which are forced to utilize these agencies as a last resort.

CONCLUSION

The small business enterprises which experience difficulty in obtaining capital and credit are concentrated largely in two sectors of the small business area: (1) That older group of enterprises whose liquid and capital assets have been dissipated in the course of recurring depressions and whose credit facilities have been cut off through the shut-down of more than 15,000 local banks; and (2) that younger group of enterprises, still in the early stages of their development, which have not yet either acumulated sufficient liquid and fixed capital or have been unable to establish permanent-credit relations.

These two groups are unable to obtain bank credit on the basis of the established credit standards and lending techniques of the commercial banks. While these two groups of borrowers may not be regarded as credit-worthy by the commercial banks, they are by no means considered uncredit-worthy by all lenders. For these groups of small business do obtain considerable credit from trade creditors, factors, finance companies, personal-loan companies, and private lenders. Although the smaller enterprises obtain credit from such extra-banking sources, they are forced to pay a high price for the accommodation and are placed at a disadvantage in relation to those of their competitors who possess adequate capital resources or have access to the regular banking channels.

A remedial program for the supply of capital and credit to small business should have as its major objective the creation of mechanisms and techniques (1) for the provision of equity capital; (2) for the supply of credit at costs sharply below present levels; and (3) to provide small business with informational service on accounting,

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[78] See, for example, appendix 2, I, p. —.

managerial, technical, and capital problems comparable to that enjoyed by the larger business concerns.

1. *With respect to the provision of equity capital.*—Of the *existing* financial institutions, the investment trust or company appears to be the instrumentality whose form is most suitable for providing equity capital to the incorporated sector of small business. The past activities of investment trusts have not, however, followed this path. Whether or not the investment trust will in the future participate actively in the provision of equity capital remains to be seen.

2. *With respect to the provision of long and short-term credit.*—That credit can be extended successfully to small business is shown by the phenomenal and profitable growth of the "retailers" of credit—the accounts finance companies, the factors, the personal loan companies, etc. The successful experience of these lenders is due largely to their having developed such techniques and methods as (*a*) pooling of risks; (*b*) routine procedures for appraisal, accounting, and servicing; and (*c*) establishment of schedules of charges appropriate to each class of risk as well as to individual risks. In other words, these "retailers" of credit have been successful in financing small business because they have devised "mortality tables" expressly designed for the financing of small business.

By encouraging the organization of additional finance and factoring companies of moderate size and a wider extension of the field of activity of the existing companies, coupled with some machinery for the coordination of their functions and activities in such a way as to reduce costs and to improve terms, the deficiency in credit facilities for small business might in part be remedied. Consideration should also be given to the desirability of providing insurance against losses sustained by such intermediary institutions either by an agency of Government or by a corporation privately financed and expressly organized for that purpose.

While recognizing that the making of "capital" loans by commercial banks is open to serious question, the practice, nevertheless, merits further thought in considering the entire problem of financing small business. If it is deemed advisable for the commercial bank to further extend its aid to small business in this direction, it must be recognized that facilities will have to be provided to protect the banks against the nonliquid and nonmarketable character of the assets which they will be required to hold, as well as against the added risks involved. Consideration should be given to the advisability under suitable safeguards for the Federal Reserve Banks or the Reconstruction Finance Corporation assuming the role of guarantor on such loans. The basic principle for such an "insurance" arrangement has already been embodied in a legislative proposal.[79]

Certain of the measures which have been proposed to Congress[80] for the provision of more adequate long-term and intermediate credits for small business recognize that the commercial banks cannot undertake this type of financing without additional mechanisms for the distribution of risk, for guidance to banks unfamiliar with the handling of small business credits, and for extensions of credits which local banks are unable to provide.

[79] See Senate Bill 1482, 76th Cong., 1st Sess.

[80] For a summary of legislative proposals, see Appendix 3, p. ——.

One such proposal [81] provides for the creation of an industrial loan corporation which would utilize the existing machinery of the Federal Reserve System. This corporation would utilize the 12 Federal Reserve banks and their 24 branches distributed throughout the country. In its operations, such a corporation would finance small and intermediate businesses through the acquisition of the obligations of such enterprises, or by the purchase of preferred stock or by making commitments to do so. The corporation could also make advances directly or in cooperation with local banks or guaranty loans made by the banks directly. Losses would be prorated between the lending bank and the corporation. The basic principle underlying this proposal is the same as that in Title I of the Federal Housing Act, which covers loans made by banks for modernization of residential dwellings. This proposal utilizes the existing banking system but endeavors to overcome some of its deficiencies in the handling of small business credits.

Among other proposals to overcome the deficiencies of the existing commercial banking system in supplying credits to small business have been those for the creation of a capital-credit banking system as a supplement to the existing banking structure.[82] Those who have urged such proposals believe that such a banking system is required not only for small and intermediate-size businesses but for business as a whole, since only through such banks can equity financing be provided.

Chairman Frank has proposed that there be established a system of regional finance companies. In each of the Federal Reserve districts there would be set up a financial institution, the common stock of which would be owned by private persons in the district. The Government would invest in their preferred stocks, but such preferred stock would have little, if any, voting power. These institutions would purchase the common stocks of local enterprise. The institutions would not make loans—they would supply equity capital. In short, the institution proposed by Chairman Frank "would be a sort of speculative finance company or investment trust." [83] Such proposals contemplate that Government would give some aid in financing the regional banks. So that Government might not own the voting stock of, or otherwise control, such corporations or the businesses in which investments are made, it has been suggested that the Government should purchase only the nonvoting preferred stocks of the proposed banks, the common stock to be held by private individuals. The latter would thus own, control, and operate the banks.

It cannot, however, be emphasized too strongly that merely to reduce the cost of credit or to make its supply more abundant will not solve all of the small businessman's problems. Nor can it be overlooked that, in addition to adequate capital and credit facilities, small business also requires that its operating efficiency and technical equipment be improved. Small business must, in order to survive,

[81] See Senate Bill 2998, 76th Cong., 2d Sess., p. ——.

[82] See hearings before the Temporary National Economic Committee, Part IX, pp. 3809–3835: Testimony of A. A. Berle, Jr. Mr. Berle's proposal would not only supply capital and credit to all business enterprises, but to governmental agencies and public authorities as well. A substantially similar proposal (but one especially designed for the needs of small and intermediate-size business) has been urged by former Chairman (now Mr. Justice) Douglas and Chairman Frank. See Hearings before a subcommittee of the Committee on Banking and Currency of the U. S. Senate, 76th Cong., 1st Sess., on S. 1482 and S. 2343: Testimony of Jerome N. Frank.

[83] Address, "Regional Financing," before the Kiwanis Club of Cleveland, April 25, 1940.

match the operating and developmental efficiencies which large business enjoys through its expert accounting, managerial, and operating techniques.[84]

Just as the credit and marketing problems of the farmer have been dealt with successfully because they have been delimited and special solutions developed for particular needs, so, too, the capital and credit problem of small business requires to be broken down into its component parts and special solutions found for its peculiar requirements.

The foregoing remedial suggestions by no means exhaust all of the possibilities; nor is it to be assumed that their presentation constitutes a recommendation for the adoption of any one. Ours is but the task of presenting the factual data upon which a solution to the problem may be predicated and of blocking out the broad lines by which the financing of the small-business sector as a whole might be undertaken.

[84] In this connection, see Senate Bill 2584, 76th Cong., 1st Sess. The impact of the war and the need for familiarity by commercial banks with technical information affecting the business and production conditions of prospective borrowers has served to bring about central advisory "clearing" facilities among a considerable number of banks. See New York Times, June 15, 1940, p. 23.

CHAPTER XVIII—APPENDIX 1

STATISTICS AND DISCUSSION

PREFACE: SOURCES OF INFORMATION

The statistical material used in this report was obtained chiefly from five principal sources and certain additional subsidiary sources.[1] The five major sources are:

I. *The Census of Business for 1935.*—Bureau of the Census, United States Department of Commerce: Tabulated material from this census is reprinted in the Statistical Abstract of the United States, which is the source cited here. The Census of Business enumerates each physical business establishment as one, without consideration of possible ownership by a multiestablishment organization.

II. *Statistics of Income.*—Bureau of Internal Revenue, United States Treasury Department: The corporation returns contained in these publications were analyzed for the years 1931–36, inclusive, the 1936 figures being the latest available at the time of writing. Manufacturing, trade, service, construction, and mining and quarrying corporations were segregated from financial and other corporations, which were defined as nonbusiness for purposes of this study. Wherever the Statistics of Income consolidate returns, as is occasionally done in the upper brackets to protect privacy, such consolidated data were added to the lowest appropriate bracket. There is no means of knowing to what extent the multiestablishment corporations have rendered combined or separate tax returns.

III. *The Census of Manufactures for 1937.*—Bureau of the Census, United States Department of Commerce: This census, complete for all manufacturing industries, also enumerates each physical manufacturing establishment as one, irrespective of possible ownership by multiestablishment organizations.

IV. *Old-age and survivors insurance.*—Statistical Section, United States Social Security Board: 6 tables, compiled in 1939, covering all employers' returns for the period January-March 1938, and especially the last day or last pay roll of March 1938, were provided for this study. These tabulations, unpublished at the time of this writing, are the second to be made by the Social Security statisticians and represent an improved methodology over the first, previously published, study. Single-establishment and multiestablishment employing organizations are segregated by industries, though not by size groups. Unlike the practice employed in the Census of Business for 1935, and the Census of Manufactures for 1937, the Social Security Board tabulations enumerate the multiestablishment organizations as one unit, regardless of the number of its component establishments. Necessarily, the multi-establishment organizations, and their number of component concerns, are based on employers' reports, and the

[1] Appendices 2 and 3 constitute the nonstatistical sources upon which the general report is largely based.

346,617 component units in the multiestablishment organizations reported to the Social Security Board are to be regarded as a minimum.

V. Statistics compiled by Dun & Bradstreet, Inc., under the direction of Roy A. Foulke: Data are cited from various publications of Dun & Bradstreet, Inc., from the testimony of certain witnesses before the Temporary National Economic Committee and from material supplied directly by Dun & Bradstreet, Inc., to the Investment Banking Section of the Securities and Exchange Commission.

Additional statistical material has been obtained from the verbatim record of proceedings of the Temporary National Economic Committee; from the Department of Consumer Credit Studies of the Russell Sage Foundation, Rolf Nugent, director; and from other sources specifically indicated in the footnotes.

ESTIMATED TOTAL NUMBER OF BUSINESS ESTABLISHMENTS

Owing to the lack of satisfactory data, only a rough estimate of the total number of business establishments in the United States is now possible, and that must necessarily be derived from several sources.

From the Census of Business for 1935, which enumerates each business unit as one, irrespective of whether or not it is part of a multiestablishment organization, the following number of establishments in the given industrial divisions is obtained:

TABLE 1-A

Business category	Number of establishments
Trade:	
Retail [1]	1,653,961
Wholesale [2]	176,756
Service, nonprofessional [3]	615,862
Manufacturing [4]	169,111
Construction [5]	75,047
Total	2,690,737

[1] Statistical Abstract of the United States, 1938, table 833.
[2] Ibid., table 829.
[3] Ibid., tables 843, 845, and 847.
[4] Ibid., tables 791 and 793. (The Census of Manufactures for 1937 reports 166,794 manufacturing establishments, a decrease of 2,417.)
[5] Ibid., table 859.

Supplementary data, though for different years, can be had from two other sources. The first consists of the figures from the Social Security Board tabulations. They include employing organizations only, for 1938.

TABLE 1-B

Business category	Number of establishments
Additional construction enterprises [1]	23,784
Transportation, unregulated: [1]	
Trucking and warehousing	28,202
Water transportation	882
Other transportation	5,466
Allied services	3,209
Mining and quarrying [1]	19,032
Not elsewhere classified [1]	7,849
Total	88,424

[1] Derived from table 6-A, Old-Age and Survivors Insurance; Social Security Board.

The second supplementary source is the Statistics of Income. The information from this source, which enables us to piece out the picture still further, is for 1936.

TABLE 1–C

Business category	Number of establishments
Agriculture and related industries:	
Incorporated [1]	7,126
Unincorporated [2]	20,866
Total	27,992

[1] Includes an unknown number of incorporated farms, which, by definition, are excluded from this study.
[2] Statistics of Income, 1936, Part 1, p. 20. No farms are included.

While the grand total of the above is 2,807,153, the three subtotals are not comparable, the first being physical units or establishments in 1935, the second employing organizations in 1938, and the third tax-reporting concerns in 1936. From this total, however, rough as it is, must be subtracted the number of employing establishments belonging to multiunit organizations, which, for every type of enterprise in 1938, was 346,617. This adjustment brings the total number of business establishments down to 2,460,536, which in the text, is stated in round numbers as 2,400,000.[2]

In the January–March 1938 period, 1,809,819 employing establishments of all types making returns for old-age and survivors' insurance reported to the Social Security Board. Of these, 293,810 were street-railway, public-utility, financial, insurance, real estate, and professional-service establishments, etc., excluded in this report, leaving 1,516,009 employing business establishments as delimited by this study. If the total number of business units is 2,400,000, since the corresponding number of employing establishments is 1,516,009, the nonemploying business units must number between 800,000 and 900,000.

BUSINESS UNITS DISTRIBUTED BY SIZE

There is no entirely satisfactory single measure of business size, and no existing size-group data cover more than a portion of the entire business field. Accordingly, the following tables present size-group distributions using various measures of size and utilizing different types of data. The outstanding feature of all of them is the overwhelming numerical preponderance of small enterprise.

Size Measured by Total Assets.

The data which make possible the utilization of this measure of size are available in sufficient detail for corporations only. The figures are given in the Statistics of Income, which, in 1936, reported data for 290,118 corporations in the business field as delimited by this study. Thus, the sector of industry covered in the following table includes practically all big business, but omits roughly 90 percent of the small business establishments and approximately 60 percent of the intermediate.

Using this measure of size, all corporations with less than $250,000 of total assets are considered small; those with total assets of $250,000

[2] Dun & Bradstreet, Inc., reports the total number of active commercial and industrial business enterprises and construction concerns in 1939 as 2,116,000. This agency disregards all business units which do not require mercantile credit.

and less than $5,000,000 are termed intermediate; and those with total assets of $5,000,000 and over are called large.

TABLE 2.—*Size-group distribution of corporations in manufacturing, trade, service, construction, and mining and quarrying, by total assets, 1936* [1]

Size classes by total assets	Number of corporations in each class	Percent of grand total of corporations	Total assets in each class (000 omitted)	Percent of grand total of total assets	Average total assets in each class
Under $50,000	173,674	59.9	$3,117,065	3.3	$17,950
$50,000 to $100,000	41,425	14.3	2,938,299	3.1	70,930
$100,000 to $250,000	37,589	13.0	5,887,689	6.3	156,630
Total, small	252,688	87.2	11,943,053	12.7	47,260
$250,000 to $500,000	16,789	5.8	5,885,674	6.2	350,570
$500,000 to $1,000,000	9,773	3.4	6,808,822	7.2	696,700
$1,000,000 to $5,000,000	8,701	3.0	17,677,184	18.8	2,031,630
Total, intermediate	35,263	12.2	30,371,680	32.2	861,290
$5,000,000 to $10,000,000	1,122	.4	7,782,347	8.3	6,936,140
$10,000,000 to $50,000,000	859	.3	16,964,827	18.0	19,749,510
$50,000,000 to $100,000,000	98	(2)	6,841,115	7.3	69,807,300
$100,000,000 and over	88	(2)	20,324,514	21.6	230,960,390
Total, large	2,167	.7	51,912,803	55.2	23,956,070
Grand total	290,118	[3] 100.0	94,227,536	[3] 100.0	324,790

[1] Derived from Statistics of Income, 1936.
[2] Less than 0.1 percent.
[3] Discrepancy in grand total due to "rounding off."

Size Measured by Number of Employees.

These data from the Social Security Board represent the most nearly complete and recent of all size-group distributions, covering 1,809,819 employing organizations, single and multiple, with 22,373,417 employees enrolled for old-age and survivors' insurance at the end of March 1938. Omitted are an estimated 800,000 recognizable business units having no employees. Included are 122,890 concerns which had one or more hired workers during the 3 months preceding the study date, but none on that date. Included, also, are 293,810 employing organizations not engaged in business as delimited by this study. These units were 16.2 percent of the total number of establishments, and employed 2,461,100 persons, or 11.0 of the total number of workers tabulated by the Social Security Board. It was not practicable to take these nonbusiness enterprises and employees out of the following table; but inasmuch as small, medium, and large employing organizations are all represented in the group that should have been excluded, the percentages are probably not greatly in error.

As a measure of business size, the number of workers employed has important qualifications. Rated solely by its number of employees, a "hand" or tool operation would loom disproportionately large, a highly mechanized operation disproportionately small. The ratio of human work to the size of operation is higher in small business than in intermediate, and higher in intermediate than in large. This measure, accordingly, not only does not truly reflect the magnitude of an operation, but also tends to overstate the size of enterprise progressively as size decreases.

Using this measure of size, all enterprises employing less than 20 workers are considered small; those employing 20 but less than 800

workers are termed intermediate; and those with 800 or more workers are called large.

TABLE 3.—*Size-group distribution of 1,809,819 employing organizations, by number of employees on last day or last payroll of March 1938* [1]

Size classes by number of workers employed	Number of organizations in each class	Percent of grand total of organizations	Number of employees in each class	Percent of grand total of employees
Occasional	122,890	6.8		
1	541,744	29.9	541,744	2.4
2 to 5	703,990	38.9	2,115,846	9.5
6 to 9	177,470	9.8	1,258,984	5.6
10 to 19	128,143	7.1	1,730,099	7.7
Total, small	1,674,237	92.5	5,646,673	25.2
20 to 29	45,224	2.4	1,076,641	4.8
30 to 49	36,850	2.0	1,391,610	6.2
50 to 99	27,418	1.5	1,886,483	8.5
100 to 199	13,797	.8	1,905,644	8.5
200 to 499	7,982	.6	2,419,095	10.8
500 to 799	1,866	.1	1,167,172	5.3
Total, intermediate	133,137	7.4	9,846,645	44.1
800 to 999	582	(2)	519,412	2.3
1,000 to 4,999	1,622	(2)	3,082,630	13.8
5,000 to 9,999	142	(2)	977,054	4.3
10,000 and over	99	(2)	2,301,003	10.3
Total, large	2,445	1	6,880,099	30.7
Grand total	1,809,819	100.0	22,373,417	100.0

[1] Derived from table 1, Old-Age and Survivors Insurance, Social Security Board.
[2] Less than 0.1 percent.

Size Measured by Value of Product.

Using this measure of size, establishments producing less than $250,000 in value of product annually are considered small; those with $250,000 but less than $5,000,000 in value of product are termed intermediate; and those with $5,000,000 or more of annual product value are called large. These data apply to manufacturing enterprises only.

TABLE 4.—*Size distribution of 166,794 manufacturing establishments, by value of product in 1937* [1]

Size classes by value of product	Number of establishments in each class	Percent of grand total of establishments	Value of product in each class (000)	Percent of grand total of value of product	Average value of product in each class
$5,000 to $19,999	50,548	30.3	$576,966	1.0	$11,414
$20,000 to $49,999	37,611	22.6	1,214,034	2.0	32,279
$50,000 to $99,999	23,661	14.2	1,683,661	2.8	71,158
$100,000 to $249,999	23,422	14.0	3,729,973	6.1	159,251
Total, small	135,242	81.1	7,204,634	11.9	53,272
$250,000 to $499,999	12,763	7.6	4,511,524	7.4	353,485
$500,000 to $999,999	8,908	5.3	6,279,012	10.3	704,873
$1,000,000 to $2,499,999	6,098	3.7	9,396,818	15.5	1,540,967
$2,500,000 to $4,999,999	2,130	1.3	7,337,152	12.1	3,444,672
Total, intermediate	29,899	17.9	27,524,506	45.3	920,583
$5,000,000 to $24,999,999	1,425	.9	14,303,848	23.6	10,037,788
$25,000,000 and over	228	.1	11,679,884	19.2	51,227,561
Total, large	1,653	1.0	25,983,732	42.8	15,719,136
Grand total	166,794	100.0	60,712,872	100.0	363,999

[1] Derived from the Summary for Establishments Classified According to Value of Products, Census of Manufactures, 1937.

THE HABITAT OF SMALL BUSINESS

Small enterprise is, of course, not evenly distributed throughout the major divisions and subdivisions of industry. It is most prevalent in retail trade, service and in the construction industry. Within the manufacturing field, small business is most largely represented in garment-making, printing, wood and leather working, and the miscellaneous group of manufactures. This may be seen in the two following tables. These tables, being limited to corporate data, omit the part played in the respective industrial divisions by the unincorporated (generally small) units. This omission is least serious in manufacturing, which is the most generally incorporated division of business, 92 percent of all manufacturing being stated as performed by incorporated concerns.[3]

In these two tables, which again utilize the previously noted total assets size classifications, capital assets (land, buildings and equipment) are shown, as indicating operative capacity; and gross sales are given, as indicating the actual degree of activity. The contrast between the two is significant, emphasizing the ability of small business to attain a relatively high level of activity in relation to fixed investment in plant.

TABLE 5.—*Number of units, capital assets, and gross sales of small, intermediate, and large business corporations in major divisions of industry, 1936* [1]

[Dollar figures in thousands]

	Number of units	Percent of units	Capital assets	Percent of capital assets	Gross sales [2]	Percent of gross sales [2]
Trade:						
Small	120, 630	92. 7	$1, 036, 454	28. 7	$15, 084, 054	38. 7
Intermediate	9, 106	7. 0	1, 301, 646	36. 0	14, 073, 831	36. 2
Large	337	. 3	1, 276, 844	35. 3	9, 786, 333	25. 1
Total	130, 073	100. 0	3, 614, 944	100. 0	38, 944, 218	100. 0
Service:						
Small	41, 223	84. 8	1, 354, 892	16. 8	1, 804, 933	44. 5
Intermediate	7, 121	14. 7	4, 762, 204	58. 9	1, 597, 550	39. 4
Large	246	. 5	1, 967, 973	24. 3	651, 212	16. 1
Total	48, 590	100. 0	8, 085, 069	100. 0	4, 053, 695	100. 0
Manufacturing:						
Small	68, 803	80. 6	1, 337, 936	6. 4	7, 240, 212	13. 6
Intermediate	15, 269	17. 9	5, 373, 695	26. 0	17, 398, 148	32. 5
Large	1, 278	1. 5	13, 978, 587	67. 6	28, 831, 148	53. 9
Total	85, 350	100. 0	20, 690, 218	100. 0	53, 469, 508	100. 0
Construction:						
Small	13, 477	92. 5	156, 615	31. 8	508, 907	64. 1
Intermediate	1, 066	7. 3	192, 550	39. 0	201, 934	25. 4
Large	31	. 2	144, 238	29. 2	83, 147	10. 5
Total	14, 574	100. 0	493, 403	100. 0	793, 988	100. 0
Mining and quarrying:						
Small	8, 555	74. 2	343, 164	5. 9	189, 786	8. 0
Intermediate	2, 701	23. 4	1, 873, 602	32. 0	817, 804	34. 7
Large	275	2. 4	3, 633, 521	62. 1	1, 350, 665	57. 3
Total	11, 531	100. 0	5, 850, 287	100. 0	2, 358, 255	100. 0
Combined:						
Small	252, 688	87. 1	4, 229, 061	10. 9	24, 827, 892	24. 9
Intermediate	35, 263	12. 2	13, 503, 697	34. 9	34, 089, 267	34. 2
Large	2, 167	. 7	21, 001, 163	54. 2	40, 702, 505	40. 9
Total	290, 118	100. 0	38, 733, 921	100. 0	99, 619, 664	100. 0

[1] Derived from Statistics of Income, 1936.
[2] Except for "Service," for which gross receipts from operations are given.

[3] Hearings before the Temporary National Economic Committee, Part 1, p. 96.

TABLE 6.—*Number of units, capital assets, and gross sales of small, intermediate, and large business corporations in subdivisions of manufacturing, 1936* [1]

[Dollar figures in thousands]

Subdivision of manufacturing	Number of units	Percent of units	Capital assets	Percent of capital assets	Gross sales	Percent of gross sales
Clothing, apparel	7, 536	100.0	$128, 641	100.0	$2, 176, 958	100.0
Small	6, 931	92.0	37, 241	28.9	1, 146, 858	52.7
Intermediate	591	7.8	66, 465	51.7	887, 769	40.8
Large	14	.2	24, 935	19.4	142, 331	6.5
Forest products	6, 067	100.0	1, 090, 964	100.0	1, 653, 099	100.0
Small	4, 700	77.5	115, 840	10.6	464, 311	28.1
Intermediate	1, 300	21.4	453, 510	41.6	873, 890	52.9
Large	67	1.1	521, 614	47.8	314, 898	19.0
Printing and publishing	11, 156	100.0	677, 906	100.0	1, 976, 241	100.0
Small	9, 972	89.4	151, 416	22.3	530, 025	26.8
Intermediate	1, 109	9.9	273, 561	40.4	882, 386	44.6
Large	75	.7	252, 929	37.3	563, 830	28.6
Leather products	2, 245	100.0	156, 841	100.0	1, 250, 883	100.0
Small	1, 782	79.4	22, 326	14.3	306, 124	24.5
Intermediate	438	19.5	70, 022	44.6	603, 375	48.2
Large	25	1.1	64, 493	41.1	341, 384	27.3
Not elsewhere classified	4, 997	100.0	438, 896	100.0	1, 494, 699	100.0
Small	4, 276	85.6	53, 948	12.3	335, 745	22.5
Intermediate	678	13.6	171, 611	39.1	691, 069	46.2
Large	43	.8	213, 337	48.6	467, 885	31.3
Textile mill products	7, 314	100.0	1, 553, 125	100.0	4, 290, 750	100.0
Small	5, 387	73.7	111, 599	7.2	689, 886	16.1
Intermediate	1, 799	24.6	787, 115	50.7	2, 255, 958	52.6
Large	128	1.7	654, 411	42.1	1, 344, 906	31.3
Liquors, beverages	2, 826	100.0	525, 285	100.0	1, 577, 232	100.0
Small	2, 091	74.0	60, 597	11.6	242, 400	15.4
Intermediate	698	24.7	330, 065	62.8	843, 951	53.5
Large	37	1.3	134, 623	25.6	490, 881	31.1
Stone, clay, and glass products	3, 527	100.0	974, 786	100.0	1, 260, 700	100.0
Small	2, 768	78.5	80, 514	8.3	180, 685	14.3
Intermediate	693	19.6	326, 460	33.5	451, 347	35.8
Large	66	1.9	567, 812	58.2	628, 668	49.9
Food and kindred products	11, 102	100.0	2, 163, 048	100.0	9, 945, 169	100.0
Small	9, 110	82.1	264, 633	12.2	1, 339, 233	13.5
Intermediate	1, 856	16.7	675, 842	31.3	3, 116, 420	31.3
Large	136	1.2	1, 222, 573	56.5	5, 489, 516	55.2
Paper and pulp products	2, 186	100.0	989, 876	100.0	1, 593, 489	100.0
Small	1, 449	66.3	39, 682	4.0	199, 478	12.5
Intermediate	664	30.4	349, 832	35.3	769, 087	48.3
Large	73	3.3	600, 362	60.7	624, 924	39.2
Chemicals and allied products	6, 212	100.0	1, 369, 971	100.0	3, 614, 105	100.0
Small	5, 028	80.9	74, 316	5.4	390, 167	10.8
Intermediate	1, 062	17.1	313, 904	22.9	1, 105, 040	30.6
Large	122	2.0	981, 751	71.7	2, 118, 898	58.6
Metal and its products	17, 912	100.0	5, 970, 951	100.0	11, 824, 407	100.0
Small	13, 768	76.9	292, 900	4.9	1, 236, 887	10.5
Intermediate	3, 792	21.2	1, 299, 347	21.8	3, 970, 582	33.6
Large	352	1.9	4, 378, 704	73.3	6, 616, 938	55.9
Rubber products	562	100.0	233, 944	100.0	937, 800	100.0
Small	372	66.2	8, 786	3.8	43, 422	4.6
Intermediate	165	29.4	87, 622	37.5	224, 518	23.9
Large	25	4.4	137, 536	58.7	669, 860	71.5

[1] Derived from Statistics of Income, 1936.

TABLE 6.—*Number of units, capital assets, and gross sales of small, intermediate, and large business corporations in subdivisions of manufacturing, 1936*—Con.

Subdivision of manufacturing	Number of units	Percent of units	Capital assets	Percent of capital assets	Gross sales	Percent of gross sales
Tobacco products	334	100.0	$82,265	100.0	$1,188,953	100.0
Small	248	74.2	2,738	3.3	22,971	1.9
Intermediate	66	19.8	11,317	13.8	89,352	7.5
Large	20	6.0	68,210	82.9	1,076,630	90.6
Petroleum and oil products	671	100.0	3,404,328	100.0	4,044,089	100.0
Small	424	63.2	11,356	.3	57,240	1.4
Intermediate	185	27.6	104.544	3.1	332,533	8.2
Large	62	9.2	3,288,428	96.6	3,654,316	90.4
Motor vehicles and parts	703	100.0	929,391	100.0	4,640,930	100.0
Small	497	70.7	10,045	1.1	54,776	1.2
Intermediate	173	24.6	76,987	8.3	326,717	7.0
Large	33	4.7	842,359	90.6	4,259,437	91.8
Total manufacturing	85,350	100.0	20,690,218	100.0	53,469,508	100.0
Small	68,803	80.6	1,337,936	6.4	7,240,212	13.6
Intermediate	15,269	17.9	5,373,695	26.0	17,398,148	32.5
Large	1,278	1.5	13,978,587	67.6	28,831,148	53.9

ECONOMIC CONTRIBUTIONS OF SMALL BUSINESS

That small business employs a disproportionately large number of workers and does so with relatively little capital outlay, is demonstrated in the following two tables. The first table shows that more workers are employed per $100,000 of value added by manufacture in small manufacturing establishments than in intermediate, and more in intermediate than in large.

TABLE 7.—*Number of workers employed per $100,000 of value added by manufacture in small, intermediate, and large manufacturing establishments classified according to size of annual value of product, 1937* [1]

Size classes by value of product	Number of establishments in each class	Number of workers in each class (average for year)	Average number of workers per establishment	Value added by manufacture in each class	Number of workers per $100,000 of value added
$5,000 to $19,999	50,548	161,896	3.2	$327,064,652	49.5
$20,000 to $49,999	36,711	305,036	8.1	659,543,513	46.3
$50,000 to $99,999	23,661	385,439	16.3	879,269,714	43.8
$100,000 to $249,999	23,422	763,574	32.6	1,799,923,615	42.4
Total, small	135,242	1,615,945	11.9	3,665,801,494	44.1
$250,000 to $499,999	12,763	857,354	67.2	2,076,254,427	41.3
$500,000 to $999,999	8,908	1,128,224	126.7	2,834,842,924	39.8
$1,000,000 to $2,499,999	6,098	1,517,198	248.8	4,157,930,600	36.5
$2,500,000 to $4,999,999	2,130	1,021,809	479.7	3,251,714,648	31.4
Total, intermediate	29,899	4,524,585	151.3	12,320,742,599	36.7
$5,000,000 to $24,999,999	1,425	1,527,333	1,071.8	5,723,913,776	26.7
$25,000,000 and over	228	901,368	3,953.4	3,463,081,044	26.0
Total, large	1,653	2,428,701	1,469.3	9,186,994,820	26.4
Grand total	166,794	8,569,231	51.4	25,173,538,913	34.0

[1] Derived from the Summary for Establishments Classified According to Value of Products, Census of Manufactures, 1937.

The second table shows that the average investment in capital assets (land, buildings, and machinery), that is to say, in "plant," rises progressively as size increases. While nearly twice as many workers are employed in producing a given amount of value in the smallest manufacturing concerns as against the largest, the fixed investment in the smallest type of manufacturing concern is only a very small fraction of the fixed investment of the largest manufacturing concerns. The following table relates solely to incorporated manufacturing corporations, capital assets data by size of enterprise being available only in the Statistics of Income.

TABLE 8.—*Investment in capital assets by small, intermediate, and large manufacturing corporations, classified according to size of total assets, 1936* [1]

Size classes by total assets	Number of corporations in each class	Capital assets in each class (000 omitted)	Average capital assets in each class
Under $50,000	43, 123	$274, 976	$6, 377
$50,000 to $100,000	12, 466	310, 742	24, 927
$100,000 to $250,000	13, 214	752, 218	56, 926
Total, small	68, 803	1, 337, 936	19, 446
$250,000 to $500,000	6, 740	889, 483	131, 971
$500,000 to $1,000,000	4, 314	1, 165, 096	270, 073
$1,000,000 to $5,000,000	4, 215	3, 319, 116	787, 453
Total, intermediate	15, 269	5, 373, 695	351, 935
$5,000,000 to $10,000,000	625	1, 687, 384	2, 699, 814
$10,000,000 to $50,000,000	519	4, 022, 666	7, 750, 802
$50,000,000 to $100,000,000	62	1, 492, 753	24, 076, 661
$100,000,000 and over	72	6, 775, 784	94, 108, 111
Total, large	1, 278	13, 978, 587	10, 937, 862
Grand total	85, 350	20, 690, 218	242, 416

[1] Derived from Statistics of Income, 1936.

TABLE 9.—*Debt and types of debt, for 290,118 business corporations, by total-assets size-groups, 1936* [1]

Size classes by total assets	Total reported debt in each size class				Percent of long-term to total debt in each class [3]	Percent of long-debt to total assets in each class
	Number of corporations in each group	Notes and accounts payable (000 omitted)	Bonded debt and mortgage (000 omitted)	Average reported debt in each class [2]		
Under $50,000	173, 674	$1, 237, 354	$220, 729	$8, 400	15. 1	46. 8
$50,000 to $100,000	41, 425	873, 639	287, 719	28, 040	24. 8	39. 5
$100,000 to $250,000	37, 589	1, 472, 156	722, 379	58, 380	32. 9	37. 3
Total, small	252, 688	3, 583, 149	1, 230, 827	19, 050	25. 6	40. 3
$250,000 to $500,000	16, 789	1, 245, 903	915, 835	128, 760	42. 4	36. 7
$500,000 to $1,000,000	9, 773	1, 300, 119	1, 072, 710	242, 790	45. 2	34. 8
$1,000,000 to $5,000,000	8, 701	2, 740, 371	2, 599, 833	613, 750	48. 7	30. 2
Total, intermediate	35, 263	5, 286, 393	4, 588, 378	280, 030	46. 5	32. 5
$5,000,000 to $10,000,000	1, 122	1, 052, 520	1, 219, 535	2, 025, 000	53. 7	29. 2
$10,000,000 to $50,000,000	859	2, 140, 781	2, 024, 812	4, 849, 350	48. 6	24. 6
$50,000,000 to $100,000,000	98	916, 731	841, 674	17, 942, 910	47. 9	25. 7
$100,000,000 and over	88	2, 382, 919	1, 532, 433	44, 492, 640	39. 1	19. 3
Total, large	2, 167	6, 492, 951	5, 618, 454	5, 589, 020	46. 4	23. 3
Grand total	290, 118	15, 362, 493	11, 437, 659	92, 380	42. 7	28. 4

[1] Derived from Statistics of Income, 1936.
[2] "Notes and Accounts Payable" plus "Bonded Debt and Mortgage."
[3] "Bonded Debt and Mortgages," as percentage of "Notes and Accounts Payable" plus "Bonded Debt and Mortgage."

TABLE 10.—*Surplus and undivided profits, less deficits, and combined net profit or loss, for 290,118 business corporations, classified by size of total assets, 1936* [1]

Size classes by total assets	Number of corporations in each class	Surplus and undivided profits, less deficits in each class (000 omitted)	Percent of surplus, etc., to total assets in each class	Combined net profit or loss in each class [2] (000 omitted)	Percent of combined net profit or loss to total assets
Under $50,000	173, 674	−$750, 629		−$61, 194	
$50,000 to $100,000	41, 425	−41, 140		60, 011	2. 0
$100,000 to $250,000	37, 589	333, 774	5. 7	194, 211	3. 3
Total, small	252, 688	−457, 995		193, 028	1. 6
$250,000 to $500,000	16, 789	626, 261	10. 6	242, 037	4. 1
$500,000 to $1,000,000	9, 773	941, 084	13. 8	300, 139	4. 4
$1,000,000 to $5,000,000	8, 701	3, 303, 935	18. 7	899, 480	5. 1
Total, intermediate	35, 263	4, 871, 280	16. 0	1, 441, 656	4. 7
$5,000,000 to $10,000,000	1, 122	1, 737, 679	22. 3	433, 784	5. 6
$10,000,000 to $50,000,000	859	4, 275, 693	25. 2	1, 007, 056	5. 9
$50,000,000 to $100,000,000	98	1, 732, 900	25. 3	402, 730	5. 9
$100,000,000 and over	88	5, 690, 232	28. 0	1, 291, 696	6. 4
Total, large	2, 167	13, 436, 504	25. 9	3, 135, 266	6. 0
Grand total	290, 118	17, 849, 789	18. 9	4, 769, 950	5. 1

[1] Derived from Statistics of Income, 1936.
[2] The "net" and "no net" corporations are, of course, combined.

NOTE.—Minus sign denotes deficit or loss.

TABLE 11.—*Total number of business establishments in relation to total population of the United States, 1901–38*

Year	National population [1]	Total number of business establishments [2]	Business establishments per 1,000 population	Index of business establishments per 1,000 population (1901=100)	Index of business establishments per 1,000 population (1926=100)
1901	77, 747, 402	1, 219, 242	15. 68	100. 00	84. 67
1904	82, 601, 384	1, 320, 172	15. 98	101. 91	86. 29
1906	85, 837, 372	1, 392, 949	16. 23	103. 51	87. 63
1908	89, 073, 360	1, 447, 554	16. 25	103. 64	87. 74
1911	93, 682, 189	1, 525, 024	16. 28	103. 83	87. 90
1913	96, 512, 407	1, 616, 517	16. 75	106. 82	90. 44
1916	100, 757, 735	1, 707, 639	16. 95	108. 10	91. 52
1918	103, 587, 955	1, 708, 061	16. 49	105. 17	89. 04
1921	108, 207, 853	1, 927, 304	17. 81	113. 58	96. 17
1923	111, 537, 497	1, 996, 004	17. 90	114. 16	96. 65
1926	116, 531, 963	2, 158, 457	18. 52	118. 11	100. 00
1928	119, 861, 607	2, 199, 049	18. 35	117. 03	99. 08
1931	124, 113, 000	2, 125, 288	17. 12	109. 18	92. 44
1933	125, 770, 000	1, 960, 701	15. 59	99. 43	84. 18
1935	127, 521, 000	1, 982, 905	15. 55	99. 17	83. 96
1936	128, 429, 000	2, 009, 935	15. 65	99. 81	84. 50
1937	129, 257, 000	2, 056, 598	15. 91	101. 47	85. 91
1938	130, 215, 000	2, 102, 000	16. 14	102. 93	87. 15

[1] Statistical Abstract of the United States, 1938, table 12.
[2] As reported by Dun & Bradstreet, Inc. Enterprises which do not use commercial credit are not included in the Dun & Bradstreet compilations.

TABLE 12.—*Estimated receivables of all consumer credit agencies in the United States, at the close of each year, 1923–37, by major classes of creditors* [1]

[Millions of dollars]

Year	Retail merchants	Service creditors	Intermediary financing agencies	Cash lending agencies	All creditors	Increment or decrement	Index of consumer credit (average 1923 to 1937=100)
1923	2,991	337	356	373	4,357	----------	70.1
1924	3,095	361	453	759	4,668	+311	75.1
1925	3,444	409	737	920	5,510	+842	88.6
1926	3,745	450	910	1,053	6,158	+648	99.0
1927	3,841	481	862	1,191	6,376	+217	102.5
1928	4,177	530	1,080	1,409	7,196	+821	115.7
1929	4,564	596	1,373	1,650	8,183	+987	131.6
1930	4,261	573	1,138	1,598	7,570	−613	121.7
1931	3,734	531	878	1,299	6,442	−1,128	103.6
1932	2,925	491	548	993	4,957	−1,485	79.7
1933	2,878	467	614	848	4,807	−150	77.3
1934	3,010	451	831	930	5,222	+415	84.0
1935	3,221	472	1,262	1,125	6,080	+858	97.8
1936	3,566	520	1,927	1,422	7,435	+1,355	119.6
1937	3,818	557	2,173	1,778	8,326	+891	133.9

[1] From R. Nugent, Consumer Credit and Economic Stability (1939), p. 116.

TABLE 13.—*Turn-over in the number of active business establishments, and business discontinuances involving losses, 1930–36* [1]

Year	Total number of enterprises	New enterprises [2]	Percent [2]	Discontinued enterprises [2]	Percent [2]	Discontinuances with losses	Percent of discontinuances	Percent of discontinuances with losses to total number of enterprises
1930	2,183,000	423,000	19.4	493,000	22.6	26,000	5.3	1.2
1931	2,125,000	355,000	16.7	413,000	19.4	28,000	6.8	1.3
1932	2,077,000	338,000	16.3	386,000	18.6	32,000	8.3	1.5
1933	1,961,000	345,000	17.6	461,000	23.5	20,000	4.3	1.0
1934	1,974,000	379,000	19.2	366,000	18.5	12,000	3.3	.6
1935	1,983,000	387,000	19.8	378,000	19.1	12,000	3.2	.6
1936	2,009,000	408,000	20.3	382,000	19.0	9,000	2.4	.4
Total	----------	2,635,000	--------	2,879,000	--------	139,000	--------	----------
Average	----------	----------	18.5	----------	20.1	--------	4.8	1.0

[1] Dun & Bradstreet, Inc., Behind the Scenes of Business, revised edition, 1937; pp. 146, 149.
[2] Including all proprietary changes, reorganizations, incorporations, etc., as well as actual births and deaths of enterprises.

TABLE 14.—*Number and percentage of small, intermediate, and large business corporations earning net income classified by size of total assets, 1932–36* [1]

Year	Small		Intermediate		Large		Total	
	Number of corporations	Percent with net income	Number of corporations	Percent with net income	Number of corporations	Percent with net income	Number of corporations	Percent with net income
1932	228,890	15.8	30,550	23.3	1,973	27.4	261,413	16.8
1933	230,543	26.5	29,303	41.2	1,948	43.8	261,794	28.2
1934	241,801	34.4	31,593	50.4	2,176	53.0	275,570	36.4
1935	247,311	37.4	32,380	56.1	2,144	60.4	281,835	39.7
1936	252,688	44.3	35,263	64.7	2,167	75.0	290,118	47.0

[1] Derived from Statistics of Income, 1932–36.

TABLE 15.—*Costs of flotation of 350 security issues registered under the Securities Act of 1933 during 1936 and 1937; classified by size of security issue* [1]

Face value of issue	Year	Manufacturing						Extractive						Merchandising						Other business [2]					
		Common stock		Preferred stock		Bonds, notes, and debentures		Common stock		Preferred stock		Bonds, notes, and debentures		Common stock		Preferred stock		Bonds, notes, and debentures		Common stock		Preferred stock		Bonds, notes, and debentures	
		Number	Cost	Number	Cost	Number	Cost	Number	Cost	Number	Cost	Number	Cost	Number	Cost	Number	Cost	Number	Cost	Number	Cost	Number	Cost	Number	Cost
Under $250,000	1936	19	19.0	5	17.8	4	9.7	8	32.8	-----	-----	-----	-----	2	12.4	-----	-----	1	4.4	-----	-----	-----	-----	1	11.5
	1937	19	18.1	8	18.1	3	9.1	11	31.6	-----	-----	-----	-----	1	11.3	1	5.5	-----	-----	1	42.2	-----	-----	-----	-----
$250,000 to $499,999	1936	23	23.3	9	19.0	-----	-----	6	25.1	1	21.9	1	8.2	2	11.8	3	9.1	-----	-----	1	15.4	1	6.7	1	10.0
	1937	14	19.1	3	22.8	5	9.6	2	25.5	1	7.1	-----	-----	1	29.3	1	16.7	1	5.4	-----	-----	2	19.5	-----	-----
$500,000 to $749,999	1936	11	18.7	4	18.8	1	4.4	3	26.7	-----	-----	-----	-----	2	20.2	-----	-----	-----	-----	1	15.4	-----	-----	1	8.1
	1937	16	17.7	2	19.0	4	10.8	4	26.0	2	12.6	-----	-----	-----	-----	-----	-----	-----	-----	-----	-----	-----	-----	-----	-----
$750,000 to $999,999	1936	11	14.9	1	10.4	2	6.9	4	34.9	2	21.0	-----	-----	1	12.4	-----	-----	-----	-----	-----	-----	-----	-----	-----	-----
	1937	8	17.8	2	14.4	-----	-----	-----	-----	-----	-----	-----	-----	1	23.3	-----	-----	-----	-----	-----	-----	-----	-----	-----	-----
$1,000,000 to $4,999,999	1936	10	11.3	4	9.2	12	5.3	5	24.4	-----	-----	1	6.5	-----	-----	4	5.5	1	4.0	-----	-----	1	10.5	1	4.6
	1937	9	14.0	7	5.6	4	5.6	3	19.7	3	20.5	-----	-----	3	9.8	3	8.3	-----	-----	3	20.3	3	13.1	1	5.7
$5,000,000 to $9,999,999	1936	-----	-----	3	4.8	3	3.9	-----	-----	-----	-----	-----	-----	-----	-----	1	7.3	-----	-----	-----	-----	-----	-----	-----	-----
	1937	-----	-----	1	3.0	2	3.4	-----	-----	-----	-----	-----	-----	-----	-----	-----	-----	-----	-----	-----	-----	-----	-----	-----	-----
$10,000,000 to $24,999,999	1936	-----	-----	-----	-----	6	3.4	-----	-----	-----	-----	-----	-----	-----	-----	1	3.7	-----	-----	-----	-----	-----	-----	1	2.7
	1937	-----	-----	2	3.3	6	3.5	-----	-----	-----	-----	-----	-----	-----	-----	-----	-----	1	4.3	-----	-----	-----	-----	-----	-----
$25,000,000 and over	1936	-----	-----	-----	-----	5	3.2	-----	-----	-----	-----	-----	-----	-----	-----	-----	-----	-----	-----	-----	-----	-----	-----	2	3.7
	1937	-----	-----	2	3.0	1	2.4	-----	-----	-----	-----	-----	-----	-----	-----	-----	-----	-----	-----	-----	-----	-----	-----	-----	-----

[1] Derived from Statistical Series Release No. 41, item 4, and Statistical Series Release No. 133, Securities and Exchange Commission.
[2] Includes agriculture, real estate, construction, and allied industries, service enterprises, and miscellaneous.

NOTE.—Cost is stated as a percentage of the total face value of the given issue.

TABLE 16.—*Sales record of securities registered in 662 statements under the Securities Act of 1933 on Forms A-1 and AO-1 between July 27, 1933, and June 30, 1938,*[1] *by quarterly periods of effective registration*

Period during which statements became effective	Number of statements	Total amount of securities registered	Registrants reporting no sales			Registrants reporting full or partial sales					Total amount sold as percent of amount registered
			Number of statements	Registered		Number of statements	Registered		Sold		
				Amount	Percent of total		Amount	Percent of total	Amount	Percent of registered	
		(000 omitted)		*(000 omitted)*			*(000 omitted)*		*(000 omitted)*		
July to September 1933	41	$19,114	13	$9,180	48.1	28	$9,925	51.9	$3,405	34.3	17.8
October to December	59	28,075	23	12,929	46.1	36	15,146	53.9	4,367	28.9	15.5
January to March 1934	49	19,890	21	10,779	54.2	28	9,111	45.8	3,840	42.1	19.3
April to June	62	23,117	31	15,743	68.1	31	7,374	31.9	2,084	28.3	9.0
July to September	29	18,692	11	6,245	33.4	18	12,447	66.6	2,094	16.9	11.2
October to December	21	8,655	6	1,740	20.1	15	6,915	79.9	3,197	46.2	36.9
January to March 1935	20	12,907	4	657	5.1	16	12,250	94.9	5,299	43.3	41.1
April to June	33	15,795	9	2,438	15.4	24	13,357	84.6	4,274	31.9	27.1
July to September	31	14,213	10	3,186	22.4	21	11,027	77.6	3,739	33.9	26.3
October to December	50	20,412	12	4,021	19.7	38	16,391	80.3	6,881	41.9	33.7
January to March 1936	40	28,759	12	6,676	23.2	28	22,083	76.8	7,196	32.6	25.0
April to June	37	30,697	12	14,887	37.5	25	24,810	62.5	7,949	32.0	20.0
July to September	42	39,581	13	9,388	23.7	29	30,193	76.3	5,999	19.9	15.2
October to December	24	12,424	5	1,971	15.9	19	10,453	84.1	3,230	30.9	26.0
January to March 1937	24	11,057	5	1,700	15.4	19	9,357	84.6	6,967	74.5	63.0
April to June	22	8,887	4	3,645	41.0	18	5,242	58.9	3,381	64.5	38.0
July to September	23	11,970	13	8,375	70.0	10	3,595	30.0	1,788	49.7	14.9
October to December	23	14,882	14	9,474	63.7	9	5,408	36.3	3,099	57.3	20.8
January to March 1938	13	4,167	4	2,356	56.5	9	1,811	43.5	983	54.3	23.6
April to June	19	7,295	8	2,407	33.7	11	4,888	66.3	538	11.0	7.4
Total	662	359,589	230	127,806	35.5	432	231,783	64.5	80,310	34.6	22.3
Status at registration:											
New ventures	446	237,230	196	104,345	43.9	250	132,885	56.1	35,431	26.6	14.9
Going concerns	216	122,359	34	23,461	19.2	182	98,898	80.8	44,879	45.4	36.7
Total	662	359,589	230	127,806	35.5	432	231,783	64.5	80,310	34.6	22.3

[1] Prepared by Research and Statistics Section of the Trading and Exchange Division of the Securities and Exchange Commission. Sales record includes sales made within approximately 1 year after the effective date of registration.

TABLE 17.—*Sales record of securities registered in 662 statements under the Securities Act of 1933 on Forms A-1 and AO-1 between July 27, 1933, and June 30, 1938,[1] by industry and size of issue*

Industry and size of issue	Number of statements	Total amount of securities registered (000 omitted)	Registrants reporting no sale: Number of statements	Registrants reporting no sale: Registered: Amount (000 omitted)	Registrants reporting no sale: Registered: Percent of total	Registrants reporting full or partial sales: Number of statements	Registrants reporting full or partial sales: Registered: Amount (000 omitted)	Registrants reporting full or partial sales: Registered: Percent of total	Registrants reporting full or partial sales: Sold: Amount (000 omitted)	Registrants reporting full or partial sales: Sold: Percent of registrants	Total amount sold as percent of amount registered	Cost of flotation: Discount and commission: Amount (000 omitted)	Cost of flotation: Discount and commission: Percent of sold	Cost of flotation: Other expense: Amount (000 omitted)	Cost of flotation: Other expense: Percent of sold	Cost of flotation: Total expense: Amount (000 omitted)	Cost of flotation: Total expense: Percent of sold
Extractive:																	
Under $250,000	123	$15, 535	32	$4, 687	30. 2	91	$10, 848	69. 8	$4, 532	41. 8	29. 2	$827	18. 2	$206	4. 5	$1, 033	22. 7
$250,000 to $499,000	65	22, 133	26	8, 527	38. 5	39	13, 606	61. 5	5, 978	43. 9	27. 0	1, 153	19. 3	175	2. 9	1, 328	22. 2
$500,000 to $749,000	26	14, 269	10	5, 463	38. 3	16	8, 806	61. 7	3, 146	35. 7	22. 0	589	18. 7	92	2. 9	681	21. 6
$750,000 to $999,000	14	11, 507	7	5, 643	49. 0	7	5, 864	51. 0	930	15. 9	8. 1	60	6. 5	24	2. 6	84	9. 1
$1,000,000 to $1,999,000	14	17, 292	3	3, 900	22. 6	11	13, 392	77. 4	4, 676	34. 9	27. 0	737	15. 8	117	2. 5	854	18. 3
$2,000,000 to $2,999,000	2	4, 875				2	4, 875	100. 0	4			1	25. 0	4	100. 0	5	125. 0
$3,000,000 to $3,999,000																	
$4,000,000 to $4,999,000																	
$5,000,000 and over	1	6, 031				1	6, 031	100. 0	53	0. 9	0. 9	11	20. 8			11	20. 8
Total	245	91, 642	78	28, 220	30. 8	167	63, 422	69. 2	19, 319	30. 5	21. 1	3, 378	17. 5	618	3. 2	3, 996	20. 7
Manufacturing:																	
Under $250,000	108	14, 014	38	4, 997	35. 7	70	9, 017	64. 3	5, 697	63. 2	40. 7	528	9. 3	312	5. 5	840	14. 8
$250,000 to $499,000	86	28, 522	36	11, 389	40. 0	50	17, 133	60. 0	10, 536	61. 5	36. 9	1, 348	12. 8	309	3. 0	1, 657	15. 8
$500,000 to $749,000	31	17, 855	13	7, 374	41. 3	18	10, 481	58. 7	6, 009	57. 3	33. 7	547	9. 1	220	3. 7	767	12. 8
$750,000 to $999,000	14	11, 734	8	6, 802	58. 0	6	4, 932	42. 0	2, 073	42. 0	17. 7	256	12. 3	78	3. 8	334	16. 1
$1,000,000 to $1,999,000	28	34, 194	14	17, 368	50. 8	14	16, 826	49. 2	4, 656	27. 7	13. 6	698	15. 0	218	4. 7	916	19. 7
$2,000,000 to $2,999,000	1	2, 000				1	2, 000	100. 0	1, 758	87. 9	87. 9	77	4. 4	8	0. 5	85	4. 9
$3,000,000 to $3,999,000	1	3, 738	1	3, 738	100. 0												
$4,000,000 to $4,999,000																	
$5,000,000 and over	2	12, 100	1	5, 775	47. 7	1	6, 325	52. 3	1, 541	24. 4	12. 7	96	6. 2	42	2. 7	138	8. 9
Total	271	124, 157	111	57, 443	46. 3	160	66, 714	53. 7	32, 270	48. 4	26. 0	3, 550	11. 0	1, 187	3. 7	4, 737	14. 7
Financial and investment:																	
Under $250,000	10	1, 513				10	1, 513	100. 0	647	42. 8	42. 8	61	9. 4	11	1. 7	72	11. 1
$250,000 to $499,000	18	6, 357	4	1, 537	24. 2	14	4, 820	75. 8	2, 560	53. 1	40. 3	207	8. 1	35	1. 4	242	9. 5
$500,000 to $749,000	9	5, 071	1	500	9. 9	8	4, 571	90. 1	1, 608	35. 2	31. 7	172	10. 7	10	0. 6	182	11. 3
$750,000 to $999,000	2	1, 730	1	980	56. 6	1	750	43. 4	747	99. 6	43. 2			2	0. 3	2	0. 3
$1,000,000 to $1,999,000	16	20, 817	2	2, 500	12. 0	14	18, 317	88. 0	6, 274	34. 3	30. 1	694	11. 1	143	2. 3	837	13. 4
$2,000,000 to $2,999,000	6	13, 850	3	6, 850	49. 5	3	7, 000	50. 5	1, 590	22. 7	11. 5	95	6. 0	14	0. 9	109	6. 9
$3,000,000 to $3,999,000	1	3, 330	1	3, 330	100. 0												

$4,000,000 to $4,999,000	2	9,400	1	4,500	47.9	1	4,900	52.1	1,031	21.0	11.0	103	10.0	5	0.5	108	10.5
$5,000,000 and over	6	37,311	1	5,175	13.9	5	32,136	86.1	2,899	9.0	7.8	198	6.8	4	0.2	202	7.0
Total	70	99,379	14	25,372	25.5	56	74,007	74.5	17,356	23.5	17.5	1,530	8.8	224	1.3	1,754	10.1
Other industries:[2]																	
Under $250,000	19	2,347	7	755	32.2	12	1,592	67.8	751	47.2	32.0	37	4.9	48	6.4	85	11.3
$250,000 to $499,000	29	9,626	11	3,551	36.9	18	6,075	63.1	2,696	44.4	28.0	115	4.3	45	1.7	160	6.0
$500,000 to $799,000	11	6,695	2	1,387	20.7	9	5,308	79.3	3,197	60.2	47.8	214	6.7	88	2.8	302	9.5
$750,000 to $999,000	5	4,209	1	923	21.9	4	3,286	78.1	1,771	53.9	42.1	82	4.6	50	2.8	132	7.4
$1,000,000 to $1,999,000	6	7,680	3	3,617	47.1	3	4,063	52.9	2,674	65.8	34.8	70	2.6	53	2.0	123	4.6
$2,000,000 to $2,999,000	6	13,854	3	6,538	47.2	3	7,316	52.8	276	3.8	2.0			13	4.7	13	4.7
$3,000,000 to $3,999,000																	
$4,000,000 to $4,999,000																	
$5,000,000 and over																	
Total	76	44,411	27	16,771	37.8	49	27,640	62.2	11,365	41.1	25.6	518	4.6	297	2.6	815	7.2
All industries:																	
Under $250,000	260	33,409	77	10,439	31.2	183	22,970	68.8	11,627	50.6	34.8	1,453	12.5	577	5.0	2,030	17.5
$250,000 to $399,000	198	66,638	77	25,004	37.5	121	41,634	62.5	21,770	52.3	32.7	2,823	13.0	564	2.6	3,387	15.6
$500,000 to $749,000	77	43,890	26	14,724	33.5	51	29,166	66.5	13,960	47.9	31.8	1,522	10.9	410	2.9	1,932	13.8
$750,000 to $999,000	35	29,180	17	14,348	49.2	18	14,832	50.8	5,521	37.2	18.9	398	7.2	154	2.8	552	10.0
$1,000,000 to $1,999,000	64	79,983	22	27,385	34.2	42	52,598	65.8	18,280	34.8	22.9	2,199	12.0	531	2.9	2,730	14.9
$2,000,000 to $2,999,000	15	34,579	6	13,388	38.7	9	21,191	61.3	3,628	17.1	10.5	173	4.8	39	1.1	212	5.9
$3,000,000 to $3,999,000	2	7,068	2	7,068	100.0												
$4,000,000 to $4,999,000	2	9,400	1	4,500	47.9	1	4,900	52.1	1,031	21.0	11.0	103	10.0	5	0.5	108	10.5
$5,000,000 and over	9	55,442	2	10,950	19.8	7	44,492	80.2	4,493	10.1	8.1	305	6.8	46	1.0	351	7.8
Total	662	359,589	230	127,806	35.5	432	231,783	64.5	80,310	34.6	22.3	8,976	11.2	2,326	2.9	11,302	14.1

[1] Prepared by the Research and Statistics Section of the Trading and Exchange Division of the Securities and Exchange Commission. Sales record includes sales made within approximately 1 year after the effective date of registration.

[2] Includes: Agriculture (1), merchandise (17), real estate (14), construction and allied (2), transportation and communication (11), service (16), utilities (6), and miscellaneous domestic companies (9).

TABLE 18.—*Data on loans and advances made by Federal Reserve banks under sec. 13b of the Federal Reserve Act*

	1934 [1]	1935	1936	1937	1938	1939	Total 1934–39
Industrial advances made:							
Number	462	973	678	247	364	243	[2] 2,967
Amount	$14,883,898	$28,479,348	$8,518,901	$4,932,169	$6,500,723	$3,805,281	$67,120,320
Industrial advances current at end of year	$14,300,694	$32,493,588	$24,652,113	$18,049,583	$15,642,701	$11,043,732	----------
Industrial advances past due 3 months or more at end of year	----------	(3)	$726,396	$1,924,343	$1,605,648	$2,565,025	----------
Miscellaneous assets acquired account industrial advances at end of year	----------	----------	$168,523	$399,482	$1,409,247	$1,214,364	----------
Determined losses charged off	----------	$1,289	$53,668	$57,673	$56,978	$560,780	$730,388
Number of loans involved	----------	1	16	5	8	15	[4] 42
Reserves for estimated losses at end of year—							
On industrial advances current	----------	$32,048	(3)	$340,012	$578,093	$328,076	----------
On industrial advances past due 3 months and on miscellaneous assets	----------	(3)	$614,472	$732,520	$1,285,176	$1,713,453	----------
Gross earnings on advances and commitments	$137,909	$1,725,620	$1,868,767	$1,295,156	$1,012,955	$780,988	$6,821,395
Expenses, exclusive of losses charged off and provided for	$473,996	$1,039,176	$719,678	$503,555	$497,442	$438,141	$3,671,988

[1] August to December.
[2] Includes duplications.
[3] Not reported separately.
[4] Excluding duplications.

NOTE.—Total advances and commitments to make advances approved by Federal Reserve banks, with and without conditions, to Dec. 27, 1939, amounted to $188,222,000.

TABLE 19.—*Applications for industrial advances (including commitments) approved by Federal Reserve banks under sec. 13b, classified according to size; June 19, 1934, to Dec. 29, 1937*

	Total	Size of loan								
		$2,500 and under	$2,501 to $5,000	$5,001 to $10,000	$10,001 to $25,000	$25,001 to $50,000	$50,001 to $100,000	$100,001 to $200,000	$200,001 to $400,000	Over $400,000
Total amount of applications approved[1] (advances and commitments)	150,982	354	1,449	2,900	10,325	17,060	22,970	22,802	28,059	45,063
Total number of applications approved (advances and commitments)	2,406	221	343	335	526	418	285	144	94	40
By Federal Reserve banks:										
Boston	124	3	12	20	24	17	17	17	9	5
New York	480	25	57	64	125	86	60	28	22	13
Philadelphia	172	13	20	19	31	31	28	12	13	5
Cleveland	201	15	17	31	43	42	28	20	1	4
Richmond	199	15	25	23	53	33	22	15	11	2
Atlanta	167	24	33	29	39	20	16	5	1	
Chicago	142	4	16	20	28	35	21	7	8	3
St. Louis	158	8	18	16	31	38	26	11	9	1
Minneapolis	297	69	63	45	48	38	23	9	1	1
Kansas City	85	6	13	12	19	14	8	10	1	2
Dallas	110	17	24	9	22	21	9	2	6	
San Francisco	271	22	45	47	63	43	27	8	12	4

[1] In thousands of dollars.

Source: Table No. 14, Twenty-fourth Annual Report of the Board of Governors of the Federal Reserve System for the year 1937.

TABLE 20.—*Applications for industrial advances (including commitments) under sec. 13b, classified according to business and industries, June 19, 1934, to Dec. 29, 1937*

[Amounts in thousands of dollars]

	Net applications received by industrial advisory committees		Applications approved by Federal Reserve banks (with and without conditions)			
			Commitments		Advances	
	Number	Amount	Number	Amount	Number	Amount
MANUFACTURER						
Aircraft	21	1,995	2	60	4	1,192
Autos, trucks, and accessories	117	26,115	28	10,689	23	9,392
Chemicals and allied products	139	3,503	13	264	22	763
Electrical goods	80	5,170	16	1,151	15	811
Food products	489	14,325	44	1,909	108	3,053
Furniture, office and household equipment	296	14,083	47	2,959	59	2,922
Hides and leather	69	2,325	4	206	7	331
Jewelry and silverware	44	1,865	3	177	9	487
Liquors, wines, and beer	222	21,482	28	3,743	24	1,515
Lumber and builders' supplies	378	19,161	71	5,910	72	4,640
Machinery and machine tools	326	19,296	40	3,111	82	5,164
Metals	317	25,589	42	3,785	73	5,634
Paper products	115	8,972	19	1,789	27	3,257
Railway equipments	13	6,887	1	20	6	6,377
Rubber goods	22	1,891	4	585	5	705
Stone, clay, and glass products	152	6,876	19	2,020	34	808
Textiles	248	21,994	35	3,756	51	5,575
Wearing apparel, shoes, etc	414	10,715	56	2,164	77	3,040
Wood products	140	4,420	19	840	29	470
Other	379	21,245	66	4,748	78	3,089
Total	3,981	237,909	557	49,886	805	59,225
WHOLESALE AND RETAIL TRADE						
Autos and accessories	335	3,851	19	246	33	290
Chain and department stores	249	8,113	19	1,433	55	1,260
Clothing, dry goods, jewelry	370	4,021	26	470	44	431
Drugs, tobacco, and liquor	210	2,301	13	286	29	410
Florists, nurseries, etc	66	1,394	12	290	11	213
Food products	624	12,816	57	3,318	69	1,163
Furniture	182	3,745	16	511	23	311
Grain, feed, seeds, etc	159	7,286	19	2,558	30	1,075
Hardware and machinery	168	3,085	13	280	26	498
Lumber and builders' supplies	372	9,220	39	1,454	66	1,615
Oil	135	4,305	11	1,610	22	512
Electrical goods	34	585	5	132	5	123
Other	245	5,383	21	427	33	418
Total	3,149	66,105	270	13,015	446	8,319
MISCELLANEOUS						
Contractors and construction	227	9,692	30	2,864	44	1,905
Hotels, apartments, restaurants, etc	130	3,935	7	171	8	381
Laundries, cleaners, and dyers	158	3,272	4	456	21	619
Mines and quarries	173	11,897	14	1,785	39	3,066
Oil and gas production	41	8,589	6	2,800	3	310
Printing, publishing, and allied trades	360	6,242	25	645	77	1,579
Shipbuilding and repairing	20	2,674	4	604	2	375
Transportation	114	4,907	11	600	14	618
Other	324	8,070	15	1,029	25	733
Total	1,547	59,278	116	10,954	233	9,586
Grand total	8,677	363,292	[1] 943	73,855	[1] 1,484	77,130

[1] Includes 21 applications each of which covered an advance and a commitment.

Source: Table No. 15, Twenty-fourth Annual Report of the Board of Governors of the Federal Reserve System for the year 1937.

TABLE 21.—*Amount of business loans authorized, by years*

	1934	1935	1936	1937	1938	1939	Jan. 1 to Feb. 29, 1940, inclusive	Total
Under sec. 5d of the Reconstruction Finance Corporation Act, as amended:								
Loans and participations [1]	$33,023,300.00	$76,528,788.85	$44,518,246.52	$18,483,534.54	$149,677,042.75	$116,697,678.50	$8,499,435.06	[1] $447,428,026.22
Under sec. 5 of the Reconstruction Finance Corporation Act, as amended:								
Loans to the fishing industry	119,500.00	589,400.00	28,200.00	72,300.00	300.00			809,700.00
Loans to business enterprises through mortgage-loan companies and banks	[2] 16,262,175.00	252,600.00		75,000.00				16,589,775.00
Under the Act of Apr. 13, 1934, as amended:								
Loans to business enterprises to repair damage by flood, etc			1,682,962.75	29,000.00				1,711,962.75
Total authorized	49,404,975.00	77,370,788.85	46,229,409.27	18,659,834.54	149,677,342.75	116,697,678.50	8,499,435.06	466,539,463.97
Conditional agreements outstanding as of Feb. 29, 1940 (under sec. 5d) [1]								[1] 107,019,525.00
Grand total authorized and conditional agreements outstanding								[1] 573,558,988.97

[1] Includes amounts authorized to be taken by participating banks, etc.

[2] 1933 and 1934.

TABLE 22.—*Number and amount of business loans authorized, by size of loans, as of Feb. 29, 1940*

Size groups	I. Loans (and participations)[1]				II. Conditional agreements outstanding as of Feb. 29, 1940[1]	
	Number loans authorized	Percent of total	Amount authorized	Percent of total	Number	Amount
$5,000 and under	3,332	36.6	$7,513,572.64	1.6	1	$5,000
$5,001 to $10,000, inclusive	1,412	15.5	11,556,985.31	2.5	1	10,000
$10,001 to $25,000, inclusive	1,739	19.1	32,181,764.67	6.9	3	54,500
$25,001 to $50,000, inclusive	1,032	11.4	41,106,882.00	8.8	5	202,000
$50,001 to $100,000, inclusive	786	8.6	61,706,912.27	13.2	6	560,000
$100,001 to $200,000, inclusive	421	4.6	64,480,693.86	13.8	10	1,578,000
$200,001 to $500,000, inclusive	278	3.1	90,740,275.20	19.5	16	5,946,000
$500,001 to $1,000,000, inclusive	63	.7	47,318,879.57	10.1	6	5,503,000
Over $1,000,000	40	.4	109,938,498.45	23.6	13	93,161,025
Total	9,103	100.0	466,539,463.97	100.0	61	107,019,525

[1] Includes amounts authorized to be taken by participating banks, etc.

TABLE 23.—*Number and amount of business loans disbursed, by size of loans, as of Feb. 29, 1940*

Size groups	Number loans disbursed[1]	Percent of total	Amount disbursed[2]	Percent of total
$5,000 and under	2,462	40.5	$4,998,402.88	1.7
$5,001 to $10,000, inclusive	874	14.4	7,029,025.16	2.4
$10,001 to $25,000, inclusive	1,095	18.0	19,987,069.56	6.8
$25,001 to $50,000, inclusive	605	9.9	23,811,690.85	8.1
$50,001 to $100,000, inclusive	502	8.3	38,349,166.38	13.0
$100,001 to $200,000, inclusive	282	4.6	42,523,590.15	14.4
$200,001 to $500,000, inclusive	193	3.2	62,118,723.72	21.1
$500,001 to $1,000,000, inclusive	44	.7	31,984,660.11	10.9
Over $1,000,000	26	.4	63,400,030.54	21.6
Total	[3] 6,083	100.0	[3] 294,202,359.35	100.0

[1] Includes number of loans disbursed by banks, etc., in which the Reconstruction Finance Corporation took deferred participations.
[2] Includes amounts disbursed by participating banks, etc., on immediate and deferred participations.
[3] Includes 960 loans disbursed in the amount of $991,505.89 to fruit growers in certain areas in Washington. Of these 960 loans, 941 totaling $833,815.89 are in the "$5,000 and under" group; 16 totaling $111,350 are in the "$5,001 to $10,000" group; and 3 totaling $46,340 are in the "$10,001 to $25,000" group.

TABLE 24.—*Number of business enterprises to which loans were authorized, and amounts authorized and disbursed,*[1] *as of Feb. 29, 1940, by industries*

	Number business enterprises	Amount authorized by R. F. C.	Amount disbursed by R. F. C.
MANUFACTURING			
Food and kindred products:			
Dairy products	137	$4,145,210.00	$1,938,366.84
Meat and poultry packing	113	5,468,587.90	2,226,833.65
Canning (fish, fruit, vegetables)	189	17,113,446.76	6,931,945.33
Beverages	67	2,049,756.03	926,240.27
Bread, bakeries, flour milling	166	3,702,393.25	1,598,487.77
Confectionery	47	2,444,200.00	1,297,550.00
All other	272	7,185,658.95	3,316,127.58
Total food products	991	42,109,252.89	18,235,551.44
Textiles and their products:			
Cotton goods and small wares	92	15,603,754.86	9,453,183.18
Woolen goods	51	12,326,798.21	8,374,662.50
Silk and rayon goods	43	8,944,750.00	6,474,279.75
Knit goods, hosiery	123	7,473,038.53	4,337,885.97
Dyeing and finishing	33	8,494,350.00	5,488,053.99
Apparel	150	4,475,520.00	1,959,488.43
All other	115	7,881,975.00	5,205,433.94
Total textile products	607	65,200,186.60	41,292,987.76
Lumber and timber products:			
Lumber	201	22,047,003.63	12,831,999.50
Furniture	158	8,162,952.75	4,749,452.40
Wooden containers	50	2,810,029.47	1,686,129.47
Millwork, sash, doors, etc	184	10,083,887.14	5,295,289.41
Wooden turned products	30	1,256,496.67	639,613.94
All other	59	1,839,150.00	662,967.27
Total lumber products	682	46,199,519.66	25,865,451.99
Paper and allied products, total	113	30,909,194.98	14,186,032.19
Printing and allied products:			
Book and job printing	171	3,314,443.29	2,025,447.07
All other	101	2,373,975.00	783,599.66
Total printing and allied products	272	5,688,418.29	2,809,046.73
Chemical and allied products, total	172	7,557,946.61	5,055,270.32
Rubber products, total	26	2,068,950.00	1,044,412.50
Leather and shoes, total	86	6,079,478.71	2,443,992.26
Stone, clay, and glass products:			
Stone, granite, slate, etc	68	2,848,425.00	1,872,007.17
Clay products	112	8,479,018.51	5,090,464.31
All other	141	9,788,907.71	5,044,395.31
Total stone, clay, and glass products	321	21,116,351.22	12,006,866.79
Iron and steel products (including machinery):			
Foundry products (castings, forgings, etc.)	78	9,498,600.00	4,664,746.04
Structural and ornamental steel	76	4,370,618.24	1,659,436.87
Hardware, plumbing, and supplies	36	3,078,215.00	1,906,331.71
Stoves, ranges, furnaces	44	5,238,816.40	2,186,222.53
All other	60	6,845,033.34	4,481,297.34
Total iron and steel products	294	29,031,282.98	14,898,034.49
Nonferrous metals and their products:			
Alloys, stampings, etc	107	6,112,654.49	3,313,324.20
All other	71	3,201,475.00	1,542,000.00
Total nonferrous metals	178	9,314,129.49	4,855,324.20
Machinery:			
Electrical machinery, apparatus, supplies	76	3,275,330.00	1,534,830.00
General machinery and equipment	95	3,746,078.58	1,709,201.72
All other	197	15,098,106.76	7,701,408.56
Total machinery	368	22,119,515.34	10,945,440.28
Transportation equipment, total	113	31,760,126.45	20,126,779.33

See footnotes at end of table.

TABLE 24.—*Number of business enterprises to which loans were authorized, and amounts authorized and disbursed, as of Feb. 29, 1940, by industries*—Continued

	Number business enterprises	Amount authorized by R. F. C.	Amount disbursed by R. F. C.
MINING [2]			
Coal	91	$14, 051, 686. 12	$6, 641, 952. 81
Other	34	3, 466, 850. 00	1, 915, 982. 08
Total mining [2]	125	17, 518, 536. 12	8, 557, 934. 89
WHOLESALE TRADE			
Groceries	132	8, 640, 805. 00	2, 064, 806. 49
Lumber and building supplies	90	2, 618, 851. 00	1, 324, 667. 00
All other	203	4, 318, 715. 92	2, 306, 434. 42
Total wholesale trade	425	15, 578, 371. 92	5, 695, 907. 91
RETAIL TRADE			
Apparel	80	783, 147. 86	277, 852. 86
Groceries	125	445, 843. 33	217, 350. 15
Drugs	64	195, 932. 04	96, 126. 36
Hardware, etc	74	516, 300. 20	228, 299. 34
Grain, feed, fuel, ice, etc	113	1, 630, 629. 67	1, 026, 141. 25
All other	694	10, 145, 886. 40	6, 366, 355. 47
Total retail trade	1, 150	13, 717, 739. 50	8, 212, 125. 43
MISCELLANEOUS			
Contracting, etc	108	3, 231, 500. 00	1, 804, 528. 78
Laundries, dry cleaning	168	2, 337, 750. 24	1, 469, 999. 43
All other	[3] 1, 304	46, 698, 814. 06	18, 631, 877. 41
Total miscellaneous	1, 580	52, 268, 064. 30	21, 906, 405. 62
Total all industry groups [1]	7, 503	418, 237, 065. 06	218, 137, 564. 13
Add—			
Loans to business enterprises to repair damage by flood, etc. (under act of Apr. 13, 1934, as amended)	213	1, 711, 962. 75	891, 372. 75
Amount authorized to be taken by banks, etc., in immediate and deferred participations (under sec. 5d)		46, 590, 436. 16	
Amount disbursed by banks, etc., on immediate and deferred participations (under sec. 5d)			[4] 75, 173, 422. 47
Grand total	7, 716	466, 539, 463. 97	294, 202, 359. 35
Add conditional agreements outstanding as of Feb. 29, 1940 (under sec. 5d; includes banks' share)	28	107, 019, 525. 00	
Grand total, including conditional agreements outstanding	7, 744	573, 558, 988. 97	294, 202, 359. 35

[1] Figures by industries represent authorizations and disbursements by the Reconstruction Finance Corporation to business enterprises under sec. 5d of the Reconstruction Finance Corporation Act, as amended; and to the fishing industry, and to business enterprises through mortgage-loan companies and banks, under sec. 5 of the Reconstruction Finance Corporation Act, as amended.

[2] Excludes mining loans authorized under sec. 14 of the act approved June 19, 1934, as amended.

[3] Includes 716 fruit growers located in certain areas in Washington.

[4] Includes amounts disbursed by participating banks, etc., on R. F. C.'s share of deferred participations.

CHAPTER XIX—APPENDIX 2

FIELD STUDIES

EXPLANATORY NOTE

Field surveys were made in the following areas representing a wide-variety of business conditions: Fall River, Mass.; Scranton and Wilkes-Barre, Pa.; Detroit, Mich.; Birmingham, Ala.; Dallas and Houston, Tex.; Omaha, Nebr.; Denver, Colo.; Seattle, Wash.; and Portland, Oreg. The Birmingham report has not been included in this appendix 2 since it served merely to corroborate the findings of the President's Committee on Economic Conditions of the South (Report on Economic Conditions of the South, prepared by the National Emergency Council, 1938). In connection with the hearings on the capital and credit needs of small business, before the Temporary National Economic Committee in May 1939, testimony was offered on the activity of the Tennessee Valley Authority in encouraging the development of small business enterprise in the Southeast. See the testimony of Mr. John Ferris of the Tennessee Valley Authority, Hearings before the Temporary National Economic Committee, Part IX, pages 3923–3943.

NEW ENGLAND AREA: FALL RIVER, MASS.

The following is quoted from the weekly bulletin of the Fall River Cotton Manufacturers Association, dated April 1, 1939:

> A few days ago a local laundryman made mention of the condition of materials running through his laundry. He said that he couldn't recollect when items like sheets, pillowcases, towels, etc., were in such poor condition. He has warned his help to be particularly careful in running these through the wringers and manglers to see that same are not torn, thereby causing damage claims. He has even noted patches on towels which he calls very unusual. He mentioned this at a laundry convention recently and was surprised by the response of a large percentage of those present who had noted the same conditions.

This quotation expresses the main problem of small business in Fall River, which is peculiarly that of a low level of consumer income, and a payroll income which comes irregularly. The state of consumer income everywhere limits local business and conditions its capital and credit requirements.

Consumer Income.

Fall River, for more than a century an important textile producing center, has a population of about 115,000, overwhelmingly factory workers and their families. The resident labor supply is thrifty and industrious. In 1937, with the community's gross wage-income higher than in a decade, 23,584 factory workers earned $18,950,567, or an average of $803.43, according to the Massachusetts Department of Labor and Industries (press release of January 14, 1939). The workers' families (largely French-Canadian and Portuguese) being above the average in size, that average income probably reflects the

income status of at least 100,000 of the population. Besides factory workers, the 1935 Census of Business of the Department of Commerce reports 4,182 employees of local retail business as receiving $3,686,000 in wages, or an average of $881.38. Combining mill payroll, "other" industrial payroll, Federal outlay and city payroll, the chamber of commerce reported that this city of 115,000 population has received outside money as follows:

1930	$28, 441, 381	1935	$26, 191, 460
1931	29, 769, 870	1936	27, 664, 526
1932	22, 751, 224	1937	31, 152, 244
1933	26, 333, 928	1938	27, 657, 460
1934	29, 649, 252	1939 [1]	7, 317, 163

[1] First quarter.

This figures at about $240 a year per person, or less than $1,000 for a family of four. Community income other than that from payrolls and relief is negligible. These conditions date from far back in Fall River's past, as a one-industry, cotton-mill town.

Standard of living comparisons with certain cities of approximately equal size follow. In Fall River meat, including sea foods, was purchased in 1935 to the amount of $138,000 against $389,000 for Wichita, Kans.; $562,000 for Fort Wayne, Ind.; and $781,000 for Reading, Pa. In purchases of shoes, Fall River was far at the bottom of the list of seven communities of equal size.

New automobile sales were $1,969,000 for Fall River, against Elizabeth $3,454,000, Erie $3,975,000, Reading $4,498,000, Fort Wayne $5,160,000, Spokane $7,748,000, Wichita $8,164,000, Miami $8,951,000. But in household furnishings and appliances, Fall River's population bought more heavily than the people of Erie, Pa.; Fort Wayne; Reading; Spokane, Wash.; or Wichita; and were outranked only by Elizabeth, N. J., and Miami, Fla. In consumption of dairy products Fall River was outranked only by Reading and Elizabeth.[1]

Employment in Fall River is irregular and unemployment is preponderantly male; daughter quite commonly supporting the family. In the last quarter of 1938 the Catholic Charities provided 27,000 food and clothing cards worth $10 apiece. During the pit of unemployment the workers and their families were fed by a town committee at a cost per person of 65 to 71 cents a week.

In Fall River the condition of low wages accounts for the survival of the textile mills. It also accounts for the rapid rise, expansion, and individual prosperity of the expatriate New York sweatshops that have come to the town of late years, as well as, in fact, the absence for them of a serious credit or capital problem. Fundamentally, it accounts also for the conservative credit policies of the commercial banks. Similarly, it accounts for the rise of the high interest commercial and personal lending that has fastened itself upon the town.

The Textile Industry.

Fall River's economic basis from 1811 to 1932 was exclusively textile manufacturing. Its decline from its original prosperous position as this country's largest "spindle city" was as gradual as it was painful. At the peak, about 1905–10, the city had 110 textile mills valued at approximately $100,600,000. Today's valuation is

[1] Census of Business, Department of Commerce, 1935.

given as $12,000,000. The closing of mills, due to southern competition, post-war export shrinkage, the rise of rayon, and the changes in women's styles, by 1927 had reduced the number of mills to 86. These had, according to State figures, $81,500,000 of invested capital. Mill employees in 1926 were 25,552. Mill payrolls in 1927 were around $425,000 a week.

In 1928 the Pocasset mill burned and set fire to the central part of town, causing $6,000,000 in property damage. Times were particularly hard from then on, weekly payrolls reaching such low levels as $129,017, $99,351, $118,147, $121,730, $131,649, $89,247 in June and July of 1932, and employment was correspondingly low.

There has, however, been a substantial recovery. In the pit of the depression the weaker and more obsolete mills were abandoned; the survivors changed hands, were reequipped, and went mainly off "grieg goods" basis. Today 22 mills, owned by 14 concerns, are in operation and these are not suffering from obsolescence. Payrolls now (1939) run around $325,000 a week and mill employees number about 12,900.

The irregularity of textile-mill employment and wage income influences profoundly local small-business credit conditions. Early in 1939, for example, the mills, on the basis of orders in sight, stepped up pay rolls from $288,172 to $336,710 in 2 weeks' time; held production at near 100 percent of normal capacity until orders were filled; kept on at peak for the sake of operating economy, ran into speculative inventory, and by mid-April were swiftly reducing pay rolls again. Although peak pay rolls continued for several weeks in March and April 1939, and were the largest since 1930 except for a short time in 1934, up to mid-April the flow of money had not reached Fall River's "Main Street." Apparently the landlord, the power company, the corner grocer, and the savings bank got first call. Since some three-fifths of the city's workers were millhands, and since no merchant or other creditor could see ahead, accounts receivable held by the stores accordingly became a gamble, and the position of every commodity distributor in the city was affected by this unpredictable variation in mill employment and wage income.

Even with this irregularity, and in its reduced state, textile manufacturing remained the most stable distributor of consumer income in Fall River, though no longer capable of supporting the entire community. No new vitality was apparently to be anticipated, nor was it likely that easement of capital or credit conditions would greatly affect the situation.

The textile mills of Fall River at the time of the study apparently were not in need of investment capital. While the mill situation had apparently hit bottom and was in process of recovery, expansion of capacity was not contemplated, nor was there need of capital outlays for modernization. For working capital, these absentee-owned concerns utilized outside credit sources and did very little banking in Fall River.

The New Industries Drive.

Aside from the textile mills, Fall River at the time of the study had 230 manufacturing establishments ranging in size from a few employees to 2,000. About half were of local origin, but the other half represented enterprises which were attracted to Fall River by its recent "new industries" drive. This was a deliberate campaign, common to all

New England, to replace the declining textile industry with diversified manufacturing plants. The Governor of Massachusetts named Fall River as the city that had made the greatest progress in 1938 in the State's new industries drive.

The basis of this drive lay in the suggestion that the huge buildings of the abandoned mill plants might again become an asset to Fall River. By 1935 vandals had looted most of these idle plants, and the mere policing of the structures had proved too great a problem for the impoverished city. A few of the empty buildings were still in private hands, but the majority had reverted to the town for unpaid taxes and so were municipally owned. There was an estimated 9,000,000 square feet of floor space in these abandoned mills.

The businessmen and bank officials of the community, with the cooperation of the town council, organized to get tenants into these structures and so create payroll. Among the city's "assets" were an abundant municipally owned water supply, a now-idle deep-water harbor, an "open shop" labor situation, and local job hunger, promising low wage scales. The "liabilities" were the bad state of the buildings, the cost of their repair, and the expense of moving. While the "drive" experienced many set-backs, it, nevertheless, gained results.

The majority of the imported plants were New York sweatshops from the garment trades. Men's and women's clothing, work garments, cotton small goods, underwear, shirts, curtains, silk and rayon apparel, and felt hats are manufactured by this group, known locally as the "needles." About 3,000,000 square feet of the abandoned mill space had been leased to these tenants by 1939. The "needles" and other imported industries had markedly reduced the relief rolls. Some of them, moreover, had grown with great rapidity. One garment concern, having only about 200 employees to begin with, at the time of the study had 2,000. Another that was small upon arrival had 1,200 employees. There were several other instances of expansion, and none had departed or failed.

Direct subsidy to induce concerns to leave other communities and come to Fall River was not the practice in this "drive." Nevertheless, the immigrant concerns were, in effect, subsidized. In the city-owned structures rents were at times incredibly low. Space in privately owned empty mill structures was renting for 2 to 4 cents a square foot, as compared to a 25-cent standard in New York. One concern, when in New York, had occupied 20,000 square feet on two separate floors, for which it paid $10,000 annual rent. In Fall River it now was occupying 30,000 square feet on one floor and paying $2,400 annual rent. At the time of the study, there was being discussed the offer of an enterprise to employ at least 100 local workers for 5 years, if it could move into a city-owned mill rent free, and then buy its mill space—160,000 square feet—outright for $1.

The Fall River banks generally accorded the newcomers favorable treatment. Although earnings were large and were plowed back into plant, working capital was being supplied locally. Certain enterprisers of local origin engaged in similar lines; in fact, complained of favoritism. For example, one local "needle" operator declared he was unable to obtain working capital, although his "ratio" was favorable and he carried an average of $8,000 on deposit at a Fall River bank.

Low rents and favorable credit relations were but two of the differentials which constituted virtual subsidies. Free water and exemp-

tion from local taxation were in some cases also granted. A resident labor supply of ample proportions, industrious by long habit and accustomed to machine tending, and eager for work at any price, was an additional factor of great importance in enabling the imported industries to undersell competitors in the national market and to expand their own earnings.

The new industries drive had put but little idle capital to work. But it did utilize some idle capital and, on the whole, profitably. The outstanding gain was that the Fall River garment concerns were better than their New York originals in space, light, sanitation, and general physical conditions. Most of them, in this respect, no longer deserved to be called sweatshops. It was obvious, however, that the existence of a low-cost competitive group within an industry composed mainly of small or medium-small concerns, would damage the credit rating of home-staying garment enterprises wherever they existed.

In Fall River itself, while the new industries drive had reduced the relief rolls, the enforced contribution of resident labor to the new industry-subsidy in the form of low wages was proving a major factor in depressing local small business. The employment of approximately 9,000 workers in industries other than textile manufacturing had not helped the merchants of the city commensurately. The "needle" employees were very largely girls and women, hired as apprentices, kept at the $8 or $10 weekly apprentice wage for a period of legal apprenticeship, then discharged to make room for new apprentices. In the case of a potentially large rubber-processing plant lately brought to Fall River, and employing males, businessmen who had helped underwrite the moving expenses of the plant complained that the low wages paid were defeating the purpose of their contribution, which was "to bring payroll into town." A few merchants spoke hopefully of incipient union attempts to elevate wage scales, and several suggested amendment of the Federal Wages and Hours Act to control the apprentice loophole. The prevailing hope, however, was that once the new industries became fully established, their wage scales, and hence the local consumer income, would rise and business then would benefit.

That the low wage levels so far had largely frustrated the "drive" was shown by pay-roll statistics of the local chamber of commerce. In 1930 textile-mill pay rolls had been $14,831,953; "other" industrial pay rolls, $8,768,560. In 1938, after 5 years of the drive, textile-mill pay rolls were $13,317,539 and other pay rolls, $9,892,303, a decline of $400,000 in total pay roll and a shift of only 3 percent toward the "other" group. Certain well-paid mechanical and water-front trades had gone out, and the "needles," with their much more numerous employment but lower wage scales, had come in.

Retail Business.

In 1935 the Census of Business found that Fall River's 1,750 retail establishments took in $31,271,000, which compares with other American cities of approximately equal population as follows:

City	Total retail sales, 1935	Percentage	City	Total retail sales, 1935	Percentage
Fall River, Mass	$31,271,000	100	Reading, Pa	$48,843,000	156
Erie, Pa	38,051,000	122	Wichita, Kans	49,464,000	158
Fort Wayne, Ind	42,668,000	136	Spokane, Wash	58,403,000	187
Elizabeth, N J	43,911,000	137	Miami, Fla	75,326,000	240

In the number of retail employees, Fall River's stores hired 4,182, against 4,639 for Elizabeth, 5,290 for Erie, 6,021 for Fort Wayne, 6,353 for Reading, 6,644 for Wichita, 6,683 for Spokane, and 10,113 for Miami.

Fall River's central business district is disproportionately small for a community of this size. Except for one department store of local ownership and one branch of a Providence department store, the largest units are those of four national chains. The bulk of the outlets are scattered through the neighborhood districts, and here, too, there are chain stores. The edge is somewhat taken off chain-store competition by the Massachusetts law requiring a minimum 6-percent mark-up.

In the food group, wholesale establishments were generally carrying the smaller "independent" outlets. Figures of the Fall River Grocers Association, covering 170 retail stores, showed an average business of $800 a week; inventory of $2,000; bills receivable from customers, $2,300; and indebtedness to supply house, $900. One wholesaler declared he could close up virtually any of his outlets at any time. Another was in process of bringing about a merger of outlets. Some chain-store managers, in order to deliver their quota of volume, were extending credit to customers at their own risk. This tended to remove the last competitive advantage of the independent grocery. The supermarket movement was growing. No opening for investment money appeared. Credit to the small grocers would be unsafe, due to the collection situation.

In retail men's clothing five outlets disclosed $8,000 cash on hand; inventories of $150,000; receivables of $81,000; and payables of $190,000. Included in the payables were various loans: $3,700 identified as bank loans, and $102,356 representing either loans from proprietors or loans from private and finance company sources.

Women's apparel business was quite generally merged into the department stores, and figures could not be segregated.

In the sale of household supplies, including furniture, radios, etc., Fall River outranked most other towns of equal population. Here, because of the repossessable nature of the goods sold, and also because the credit buyer had created a legal form of lease, the discounting of receivables for cash to some extent entered the picture. Concerns doing an installment-credit business enjoyed relatively little aid from the banks and were considerably extended. Six concerns had total inventories of $114,000, receivables of $340,000, payables of $130,000. Of the payables, less than $10,000 was payable to banking concerns. The rest was owed mainly to the supply houses, which quite generally demanded cash far in advance of customer installment payments—one important national refrigerator concern through its finance company was reported as keeping watch on merchants' warehouses and demanding full cash as soon as an item was gone. A local finance company accepted installment receivables, but its resources for this purpose were limited. One retailer, with $35,000 receivables currently being discounted, considered this limited capacity of the financing company a limit upon his own business. Another had investigated and found that finance company discount rates would swallow up his profit margin, hence he did his best to finance himself and was perpetually pressed for cash.

The lumber and building supply industry was small, and there was virtually no new building activity. A limited amount of moderniza-

tion work, requiring lumber, was federally financed. There was price competition between dealers, and a concern that had had more than one informal settlement with trade creditors was accused of price-slashing practices.

A summary of 40 balance sheets, taken as a cross section of the various business groups, indicated the general position as follows:

	Cash	Inventory	Receivables	Payables	Bank loans [1]	Other loans [1]
Miscellaneous small manufacturing	$56,263	$480,000	$300,000	$580,000	$108,000	$60,299
Food products	12,968	140,000	150,000	308,000	18,000	101,882
Builders supply	5,979	94,000	106,000	126,000	2,200	19,375
Household supply	25,127	114,000	340,000	131,000	12,900	6,150
Retail clothing and shoes	8,125	150,000	81,000	190,000	3,700	102,356
Services	1,760	1,020	26,700	47,000	4,400	32,875
	110,222	979,020	1,003,700	1,382,000	149,200	322,937

[1] Included in payables.

The receivables of these 40 establishments were greater than their existing inventories, but their payables were more than their receivables and cash together. The enterprises were in debt 42 percent more than the value of their inventories. These figures were typical of the general "frozen" condition, arising from the practice of extending credit as a means of getting business, the low level of consumer ability to pay, and the tightness of bank credit.

Banks and Bank Credits.

In the above table, bank loans were less than 11 percent of the total payables of the 40 enterprises. The percentage probably is a fair indication of the extent to which the credit needs of the business community were not being fulfilled.

The three commercial banks were found to maintain an extremely liquid position. Their combined reports showed total assets of about $20,000,000; cash, $4,750,000; United States Government bonds, $4,000,000; State and municipal bonds, $2,350,000; and other liquid securities, $1,750,000. Of this total of $12,800,000 in "liquids" there was $6,000,000 outstanding in total loans. Deposits were $18,000,000. The indicated unused credit capacity was ample to finance the town's business, had the security been acceptable to the banks.

In the fire of 1928, two banks were burned and their assets were merged into a third. This bank then had loans outstanding of $11,800,000. Conferences were called with the two other surviving banks, at which duplicate debtors were identified and their debts consolidated and allocated to individual banks. Also, worthless security was written off. The latter bank reduced its loans from $11,800,000 to $1,500,000 in the years that followed. Some debtors of the period preceding the debt consolidation are still paying as little as 25 cents a week. Foreclosures have been avoided. But the policy of reducing the indebtedness of Fall River bank borrowers has prevailed over the policy of granting new loans.

The attitude of two of the three local banks, as expressed to the staff representatives, was that the small businessman individually, rather than any underlying community conditions or compulsions, was to blame for restrictions upon credit. It was reiterated, both in

general and as to concrete cases, that the local small businessmen were prevailingly incompetent in two major respects—in their over-eagerness to incur debt and in their propensity to expand whenever financial restrictions were relaxed. Credit applications were, therefore, subjected to intense scrutiny, features of which were, at various times: Special audits at the applicant's expense by auditors designated by the bank; contacting and at times direct interviewing of trade and other creditors; inquiry into the applicant's personal life, expenditures, and interests outside his business, as indicative of his character, personal debt position, and withdrawal policy; knowledge of family connections; historical record in abundant detail. Thus, a bank was about to extend credit to a man and his wife associated in business, when it came to light that a divorce complaint had been filed by one of them against the other in the past, and withdrawn. In spite of the evident reconciliation, the credit was denied. In another case, credit was granted to an enterprise which the bank regarded as somewhat precarious, but whose proprietor had a family connection which the bank regarded as protective. In a community of this size, such personal considerations were known and played an important part in the extension of credit.

Rigid programs of managerial reform were at times set up as a condition precedent to credit extension. Small businessmen had been required to cut down space and display, reduce advertising, eliminate employees, restrict their living standards. Sales aggressiveness, expansion, and other risk taking were discouraged under this lending policy. One result of this policy was that losses on bank loans were practically negligible, but few loans were applied for and fewer made. On loans that were made, the terms were short, but renewals were not infrequently allowed, the prevailing total time allowance rarely exceeding 9 months.

These banks did not appear to object to small businesses finding credit elsewhere. For example, they regarded it as normal that supply houses should be the main source of credit for small business, pointing out that central supply houses could go to centrally located banks and borrow against their receivables. By lending to the trade creditors the banks believed that they were properly carrying on the functions of commercial banking. Similarly, these bankers did not especially deprecate the growth of the loan-shark evil in Fall River, pointing out that individuals who loaned money to business at high rates were taking a commensurate risk.

One bank had a more liberal policy. It was developing the personal loan business. It was also fostering F. H. A. loans through an advertising campaign. Some rival bankers criticized this campaign, as tending to make people incur debt and put money into homes instead of keeping themselves liquid. This bank had a larger proportion of loans and discounts outstanding than its more conservative competitors. In connection with its personal loans, it was giving some business aid of a retail character. Merchants were bringing to this bank individual indebted customers and signing their notes as comakers. By this means the merchant received his money, and the customer paid it in installments to the bank. Technically, the merchant as comaker was under obligation for the customer's full indebtedness in case of default, and the transaction, accordingly, should have been entered as a contingent liability on the merchant's

books. However, this was not the usual accounting practice, these receivables being ordinarily accounted for as paid. That this type of relief was being utilized even by the larger stores was ample evidence of the straits to which small business was put to turn its customer receivables into cash. But the total of relief by this means was small. Although this bank went considerably further than its competitors in "trusting" the business community and the individual borrower, it reported that failures to repay were negligible.

Nonbank Money Lending.

In the $1,300,000 total of payables of the 40 concerns previously mentioned, 24 percent was listed as money loans from sources other than the banks. This indicates the result of the limited availability of bank credit. Fall River had developed a private "loan-shark" activity of exceptional vigor. It had also seen the growth of a strong local finance company, with banking connections outside the town.

This local finance company was one of a group of business corporations maintaining separate legal entities, but under common ownership and control. These corporations were active in real estate, machine junking, and marine wrecking, ownership of factories, and the financing of machinery repairs, receivables, etc. They also included a "personal holding company." Thus one general financing contact with a business might have various ramifications, each a separate deal with a different corporation. As far as local business was concerned, this group of enterprises was reputed to be the outstanding source of equity capital and credit in the community. Its active head summarized the local situation to the staff representative by stating: "The banks are my best friends. They don't want to furnish money to small business; I do."

It was well known in the business community that money was to be had from extra-bank sources if one would pay enough for it. The costs for [this type of loan, including holdbacks, interest, service charges, and fees exacted under color of payments for "business advice," were widely reported as being 35 percent on the money received. On the balance sheets of business concerns, nonbank payables were at times listed as loans from "officials", or from "partners." In some cases these were genuine reinvestments by the original owners, but in others they referred to the acquisition of business equities by "loan sharks" as an alternative to foreclosure. Cases were reported from that of the businessman who said he had been told he could have $75,000 but it would cost him $100,000 plus interest to pay it back, to that of the man who said he had borrowed $30,000 by mortgaging his home. his business equipment and stock, some property owned privately, and assigning his own bank account and that of his child, and upon repayment had been met with a demand for an additional $3,000 as a "service charge."

In a deal of a somewhat different type, a private party had bought a business equity under terms that stipulated the payment of regular interest on the investment, plus a fixed weekly withdrawal of $100 in summer and $75 in winter as a preferred payable of the enterprise. It was figured that this equity sale cost 22 percent annually on the amount of capital received, as a perpetual burden on the business.

MIDDLE EASTERN AREA: SCRANTON AND WILKES-BARRE, PA.

The Wyoming Valley of Pennsylvania, with a population of 652,512, includes the cities of Scranton, with a population of 143,433; Wilkes-Barre, 86,626; Nanticoke, 26,043; Kingston, 21,600; Carbondale, 20,061; Pittston, 18,246; and more than 40 other incorporated boroughs.

Anthracite coal has been and still is the major industrial product, the Wyoming Valley being one of the two principal anthracite areas in the United States. This industry, which includes 5 large and some 140 small operators, employs approximately 60,000 persons locally. The serious decline in Pennsylvania anthracite production from 92,653,641 tons in 1923 to 45,054 tons in 1938 was shared by this area with a drop of 44 percent. Serious unemployment ensued, there being at the time of the study about 30,000 local unemployed in the Wilkes-Barre area alone.

But the locality is not entirely dependent on anthracite; the largest lace mills in the United States are located there, and it is second only to Paterson, N. J., in silk manufacturing. There are also numerous plants devoted to food processing, and other small manufacturing establishments of nearly every description. The number of persons employed, outside of anthracite, was about 45,000 including 21,000 women.

Regional efforts, vigorous and organized, were concentrated upon the development of diversified small manufacturing, it being recognized that the decline in anthracite was due to conditions beyond local control. But a dearth of local capital for investment and a shortage of bank credit had not only largely frustrated progress in this direction, but constituted the gravest problem for the existing small industries. The difficulty hinged upon the inherent limitations of the institutional sources of capital and credit.

Under such conditions, the numerous small manufacturing enterprises of the Wyoming Valley had developed an unusual variety of substitute forms of financing. But these did little more than permit enterprise to survive, constituting a problem in themselves.

Some of the Financing Devices Employed in the Community.

Anthracite coal.—In general, the small anthracite concerns were found to lease their mining properties from one or another of the old-line companies, which own among themselves about 90 percent of the coal deposits. The lessees paid royalties, and were usually obligated to pay all taxes, as well as to maintain the properties.

Some of the small anthracite concerns turned over all coal they mined to a large company, of which they were virtually the subsidiaries. Others had their own sales facilities or outlet contacts, of which there were 31 locally handling anthracite. Some had grown from small investments to sizable scope, others had remained small; some were marginal. There appeared to be no risk capital in sight anywhere for these independent operators. This had hampered their technological development. Similarly, the need of capital on the part of a local manufacturer of small mining machinery under a German patent, adapted to the independent operation, had been openly advertised but had gone unfilled, with the result that its term sales of such machinery were handicapped.

The silk industry.—There were approximately 150 silk manufacturing concerns in the region. The majority were small "throwsters," spinning or "throwing" the raw silk into yarn; the remainder were engaged in spinning silk and in weaving either the unfinished "greige" or "gray" goods or the finished product. The latter were largely connected with interests located at Paterson, N. J., and New York City.

The throwsters, with certain exceptions, worked on a commission basis, to obviate the need of working capital for purchasing raw silk. That is, the manufacturers of hosiery and other knit silk goods, largely in other centers, purchased and continued to own the raw silk which the throwsters made into yarn. Other cash requirements of the throwsters were being covered, with considerable difficulty, through small bank loans secured by mortgage of buildings and machinery, and in some cases through cash advances from the concerns commissioning the work. As a result of this long-standing situation many throwsters had lacked sufficient capital to modernize, and were at a serious competitive disadvantage with silk throwsters located elsewhere.

Other throwsters, however, had obtained modern equipment through conditional sales agreements at comparatively high rates of interest, but the cost of machine purchases on time was serious in so competitive a business, where the difference of a small percentage in financing costs often meant the difference between profit and loss.

Silk weaving had been hard hit, both by the depression and by southern competition. Many mills in this region had closed, gone into bankruptcy, or moved to the South. Employment had been reduced from a former peak of 3,500 weavers to less than 2,000 at the time of the study. Wage differentials apparently accounted for less of this decline than the fact that the southern mills were equipped with automatic machinery enabling one man to tend 40 looms, whereas locally, by union agreement, one worker had tended 18 looms; although shortly before the study, in view of the competitive situation, the agreement had been relaxed to allow one worker to tend as many as 24 looms. This incurred a certain danger of machinery breakdown and yardage loss, and it was apparent that this industry faces the necessity of either obtaining the new type of loom, or of further liquidations. The surviving companies, with a few possible exceptions, lacked capital and credit for modernization. Such financial aid would, in the opinion of local leaders, readily enable this long-established industry to meet competitive conditions more effectively.

Some silk mills, like the throwsters, were doing their weaving on commission in order to eliminate the need of purchasing raw materials. Others obtained their raw silk from central New York dealers on trust certificates, by which all title to the material, and to the goods in any stage of manufacture, remained vested in these central concerns. Under this plan, the weaver paid interest, insured the property adequately, and paid for the services of a custodian. The weaver made the sales, striving to reimburse himself for the interest, insurance, and custodian costs, as well as operating costs, from the proceeds of the sales.

Factoring in the Silk Industry.

In this industry, where factoring has long been entrenched, the accessibility to markets is largely in factoring hands and almost all weaving companies must sell through them. The factor guarantees the credit of the customer and assumes the full risk for those receivables which he finds acceptable; he also replaces the accounting and collection system which the weaving concern otherwise must have. For performing these services the factor's commission is usually 2 percent on sales, plus interest on moneys advanced to the business, less interest on clients' surpluses.

These charges, and the control of credit sales exercised by the factor, were described by some as "an unmitigated evil." The complaints were directed less against the factoring charges proper, than against the limitation of markets, arbitrary selection of some credit risks and rejection of others, and control of credit terms, with consequent restriction of sales volume. Factoring was held responsible for the inability of some concerns to boost their sales above the break-even point. Also complained against were the auditing fees, accounting costs, and legal fees often paid by the manufacturers at the factors' behest, for supervision of the business. Undoubtedly, factoring had reduced credit risks and losses, but to the businessmen interviewed the fact that their business operations were restricted by being "in the hands" of the factors was a source of grievance.

General manufacturing: Field warehousing.—A credit device employed by the small manufacturers was that of obtaining bank credit on security of warehouse receipts. The field warehousing plan amounts to the hypothecation of salable inventory. It seems to have originated to aid canners and others with highly seasonal operations, and to have spread to other manufacturers under pressure of credit stringency.

The actual cost of money raised by pledging warehouse receipts was found, in the case of the average small manufacturers, to be around 12 to 14 percent. This included bank interest, at 6 to 8 percent, plus fixed charges; the latter including the cost of storage in a warehouse of the bank's selection, a fee for a designated custodian of the inventory with the duty of keeping account of all sales, insurance on the inventory, and premium on the bond which the bank ordinarily required. While the interest charge was naturally reduced in proportion to the amount of the credit, the fixed charges were not, with the result that for the smallest loans the cost became excessive.

An additional point of strain occurred when some portion of the hypothecated inventory was sold by the manufacturer on credit. This involved the question of whether the bank would accept the substitution of the purchaser's credit for that of the manufacturer, or whether the appropriate portion of the bank credit must be retired. Usually, the substitution was accepted with the added endorsement of the manufacturer on the equivalent of the "recourse" arrangement; but there were instances where this had not occurred and the manufacturer found his inventory to that extent "frozen."

As a typical instance of this method of financing, there may be cited the case of company X. This manufacturer and wholesaler of folding boxes and display cartons, with a history of flood losses and compromise with trade creditors, had at the time of the study $10,000 in inventory, receivables of $5,600, trade acceptances of $1,800 and a

small amount of cash. Against its inventory was a bank loan of $4,850 at 6 percent, and it had other payables of $5,650. The warehousing costs were at the rate of $300 annually, or more than the amount of the interest. The total loan cost of more than 12 percent was an important item to a concern with $100,000 annual volume of sales.

A somewhat different case is that of the L Furniture Co. This company manufactures and sells mattresses and upholstered furniture to department stores and other retailers. Its total assets were $95,000, of which $60,000 represented real estate and plant. Its accounts receivable amounted to only $2,500 and its inventory was carried at $10,000. Of the company's liabilities, $23,000 were in bank loans, which were secured by a mortgage on real estate and the pledge of life insurance policies. Sales and collections were good and the company's paper found a ready market with finance companies. However, the concern could have added 50 percent to its volume of business and, since overhead would have remained relatively stationary, increased profits more than proportionately, of adequate capital could have been obtained. The company tried various ways to raise money. It found that it could not borrow from the banks without additional collateral, and that it could only resort to borrowing on inventory through the medium of warehouse receipts. Since this would mean paying between 12 and 14 percent for its money, the company declined to obtain funds in this way.

The banks.—The volume of commercial loans at the local banks was comparatively large although the average individual line of credit was not great.[2] All of these loans were secured either by pledge of collateral or by endorsement. In one bank there were approximately $400,000 in commercial loans outstanding. Of these, a little less than half were secured by endorsement and for the remainder the collateral was life-insurance policies. The "going" rate of interest was 6 percent. But in the majority of cases the interest rate was reduced for large borrowers because they were able to go to New York, if necessary, to obtain a lower rate. In only one instance was the lower rate extended to a small borrower by the banks charging 6 percent. One bank in Scranton, however, worked on a straight 5-percent basis, extending this rate to all borrowers, and making no reductions even in the case of large loans. An official of this bank stated that since the lower rate was put into effect the bank's commercial loans increased considerably. Outside of the bank, on the other hand, the opinion was that the advantage of the lower interest rate was offset by the fact that the bank took only the "cream of the business." All bank loans, excepting mortgages on real estate, were for short periods. Only two instances were found where, with the permission of the F. D. I. C., loans other than on real estate were made for a term of 3 years or more. Both these loans were made by a bank in Wilkes-Barre, one of them being extended to a new hosiery company, which was induced to come to Wilkes-Barre by the chamber of commerce. The bank loaned this company $40,000 to be paid off over a period of 3 years, the loan being secured by a pledge of the company's machinery. In this case, however, the risk element was practically negligible, because the local hosiery company sold its

[2] Cf. the Survey of Credit and Capital Requirements Among Small and Medium-Sized Business Establishments, p. 35, issued by the Department of Research and Statistics of the Federal Reserve Bank of Philadelphia.

entire output to a large Philadelphia company which fully guaranteed the loan.

Except in rare cases the banks did not discount accounts receivable, and they did not encourage the discounting of trade acceptances. Exceptions were made in the case of old accounts or when enterprises were already heavily indebted to the bank, in which instances the banks appeared to discount not only acceptances but also ordinary receivables.

A case in point is that of the M Company. This concern is located in Scranton and is engaged in the manufacture and sale of wooden caskets, store fixtures, and church furniture, among other things. The enterprise has been operating at a loss for some time and its stock was deposited under a voting trust agreement. Recently the trustees effected a change in management. The company had quick assets of $244,000, of which $117,000 represented merchandise, $89,000 accounts receivable and $36,000 notes receivable. Against its fixed assets of $301,000 there was outstanding a real-estate mortgage amounting to $138,000, of which $120,000 represented the share of the bank in question. Additional security for this loan in the form of life-insurance policies having a cash surrender value of $30,000 and a face value of $100,000 was pledged. The receivables of this company were not of the best kind, but the bank nevertheless discounted approximately $50,000 of the concern's accounts and notes receivable for the sole purpose of keeping it in operation.

Community Attempts at Capital Relief.

Two community endeavors to relieve the capital and credit stringency had been made by the Scranton Investment Development Co. and the Wyoming Valley Development Fund.

The former was originally set up by the Chamber of Commerce for the purpose of establishing new industries in Scranton. Losses had been sustained, and at the time of the study the fund, reduced in size, was utilized only for the making of small loans without formal security to business operators well known to the Chamber of Commerce. Loans as high as $5,000 had been made and in a number of instances such loans had tided the concerns over difficult periods. While this fund turned over steadily and was a local convenience, its operations were not sufficiently widespread to be of general assistance to small business enterprises throughout the community.

The Wyoming Valley Development Fund, with resources of $80,000, was raised from local businessmen for the purpose of reducing unemployment. Eight new establishments, some imported and some of local origin; the reopening of three enterprises that had been closed; and current negotiations with approximately 35 possible "immigrant" concerns from other sections, summed up its achievement at the time of the field study.

The experience of the managers of this fund showed that there was a pressing need on the part of the small enterprises for working capital. The constant problem faced was that of the development or redevelopment of business for new employment purposes; and the constant obstacle encountered was the limitation on the supply of short-term credit. There was also present an even greater need for medium-term credits.

A specific instance in which the Chamber of Commerce became interested, and in which the Wyoming Development Co. participated

was that of Mr. R. This man operates a small garage and motor parts business. He carries a small supply of fixtures and his receivables are small. Purchases are made for cash and his liabilities are not heavy. Within the past 4 years, Mr. R. has invented and patented a device for reshaping worn pistons. By his process, worn pistons are expanded by the application of heat and then reground to form a perfect fit. It is claimed that his process does not alter the composition of the metal. A small bank loan enabled Mr. R. to obtain his patent and to build a couple of machines. He has been able to operate in Scranton with considerable success and does approximately 80 percent of all the piston work in the city. A loan of $1,500 from the Wyoming Development Co. enabled him to retire his bank loan and to build several additional machines. Despite this aid, however, his resources were wholly inadequate for his purposes, and there appeared to be no other agency from which he could obtain the capital which he needed to expand his business in accordance with current requirements.

Testifying before the Temporary National Economic Committee, Mr. T. N. B. Hicks, Jr., manager of the Wyoming Development Fund, stated:[3]

I don't know where you can get a mortgage on an industrial building today * * * if it is a case of a new building for a new industry or an addition to a building for an expanding industry, or an industrial project * * * that needs to purchase or remodel * * *, a mortgage is practically out of the question. I don't know where to go for one and I've made repeated efforts * * *.

The second major difficulty * * * involves the financing of machinery and equipment in cases of plants which wish to expand * * * and in cases of new industrial enterprises. The only method whereby a small business house today can finance new machinery or equipment is on a lease purchase plan for the manufacturer of equipment. That involves an added cost of machinery which ranges in some cases to only 10 percent, in other cases 25 to 30 percent. It seems the small industry * * * is simply saddling itself with a fixed charge * * * which tends to throw it out of competition.

Mr. Nehemkis. "What is the third major problem?"

That is the problem of getting needed working capital, particularly in a business that is growing and expanding. A small business, one that has started small and has grown right along, has in practically every case found it necessary to put all its available funds into the type of assets that are commonly termed slow or frozen assets. They go into real estate and they go into machinery; they go into supplies and certain types of inventory which are difficult to develop for collateral purposes.

When they reach the stage that they need more working capital for current operations, they either are unable to get it at all or they must get it by various methods which represent an excessive cost * * *.

Capital for New Enterprise.

In his narration of cases where the fund had assisted in making needed adjustments, Mr. Hicks referred to the importance of capital for new ventures:[4]

I won't say it is not obtainable, because there have been some cases where we have been able to work it out, but there have been so many cases where we have not been able to work it out that I think the answer is that it is difficult to obtain in all cases, and impossible in a great many of them.

Referring to the need of working capital for expansion, he commented:

It is simply the type of loan for which there is now no existing machinery. It falls into the territory which lies between that of the commercial banks and that

[3] Hearings Before the Temporary National Economic Committee, Part IX, pp. 3948–3949, 593–600.
[4] Idem, p. 3949.

of the investment banker, either as to the nature of it or as to the size of the loan. I am not now speaking of the highly speculative ventures, but those that are sound.

GREAT LAKES AREA: DETROIT, MICH.

Detroit, of all the regions included in the field study, was the area of greatest industrial magnitude. According to the Census of Manufactures for 1937, the motor-vehicle industry alone, consisting of 13 corporations of major size, accounted for an output valued at $747,-000,000 and for an average employment of 63,000. In addition, motor-vehicle bodies and parts concerns, consisting of 63 companies with 58,000 employees, turned out a product valued at $446,000,000. Even without the automotive industry, however, Detroit would be industrially important as a center for the manufacture of machine tools; stamped and pressed metal products; non-ferrous-metal alloys and their products; paints, pigments, and varnishes; wire working; many other types of products. In 1937, there were more than 2,000 manufacturing establishments in Detroit with an annual output valued at $5,000 or more. These enterprises employed more than 235,000 wage earners throughout the year and produced goods valued in excess of $2,000,000,000.

Detroit is preponderantly a big-business community. But Detroit also has a great many small-business enterprises in manufacturing, to say nothing of the small local trade concerns. While these tend inevitably to be subordinated in the general picture of bigness, they are of considerable importance numerically and because small business in Detroit, in recent years, has encountered extraordinary financial difficulties.

Study of the Detroit area, it was believed, would throw light on the general question of how the small enterprise, especially the independent, personal types of business, fares in the shadow of some of the greatest industrial corporations in the Nation. Large pools of capital and credit obviously being present, the availability of capital and credit to small business under these environmental conditions emerged as a central question.

Equity and Venture Capital.

Equity capital for individual small enterprise was, so far as could be determined, not available. In respect to venture capital for new enterprises, the situation was acute, due to peculiar local conditions. Of all American cities, Detroit has probably the greatest number of inventors, with patents on file and blueprints ready for development. These inventors appear to have been attracted to Detroit by its fame as a mechanical center. Many of them have worked in automobile, chemical or other plants and having perceived the need of some particular device, they have proceeded to develop it independently. Others have come here to market inventions made elsewhere.

Yet it would be hard to find an area where venture capital to back such inventions is more scarce. Two typical cases may be mentioned. In one, the invention was a superior lining for stoves. The inventor of this product wanted to retain his proprietorship; but unable to find capital, he had, finally and reluctantly, sold out on a royalty basis to a large stove concern. The other case was that of an invention for applying electricity to the drying of concrete, thus controlling the process. In this case, $200 was raised from individuals for a demonstration, and when it was shown that concrete bricks dried by this

process had superior tensile strength, a small company was organized. The company, however, was unable to raise the needed capital in Detroit. It finally interested a Canadian concern, and a contract was worked out which gave the company the benefit of any improvements the Canadian company might make, plus a royalty on all sales made in Canada.

Inventors of automotive devices either have to sell out to existing automobile companies, which many hesitate to do, or see their inventions remain undeveloped. This situation has been regarded so seriously by the Detroit Board of Commerce that a committee was formed to consider the possibility of leasing a vacant plant, installing a hundred inventors, raising a fund to finance them through the initial developmental stages and, in the meantime, training them in sound accounting and managerial methods. It was argued in behalf of this proposal that if only a small minority of the inventions so financed proved successful, the capital would be profitably invested, at the same time that local employment would be aided and national progress fostered. At the time of the field study, this plan had not yet been translated into practice.

The availability of equity capital for the expansion of established small industries appeared to be equally lacking in Detroit. Local sources had been repeatedly canvassed by small businessmen in need of such capital but without success. In one case, a radio-control device for opening garage doors and turning on lights from a car's dashboard had become fairly well established locally, and many of the wealthier citizens had installed it, but equity capital could not be obtained for its extension into other markets. In other instances, small enterprises had attempted local security flotation, but without success.

The Credit Situation.

Detroit has six principal banks. The combined resources of these banks alone, it was generally believed, could finance the entire business needs of Detroit. These banks, at the end of 1938, had combined deposits of $745,489,000. Total cash was $242,052,000; Government securities, $342,862,000; and commercial loans and discounts were $134,398,000. The latter figure included an unknown amount of credits to intermediary financing concerns. Certain of these banks are commonly regarded as having close relations with specific automobile interests.

Despite the large resources of the Detroit banks, small businessmen find credit accommodations very difficult to obtain. Specific explanations for this credit stringency were advanced by individual bankers. Among the explanations advanced were the severity of Federal bank inspections; the uncertainty of the operation and standards of Federal agencies; the uncreditworthiness of the majority of small business applicants; the absence of sound management qualities of a preponderance of the small business group; and a general "lack of confidence" in business conditions. Among small businessmen, two other explanations prevailed. One was that the troubles of the Detroit banks in the depression had led to an almost psychopathic avoidance of even normal risk, the leading personnel of most banks having changed but little since that grim experience. But more often expressed was the opinion that these were "big business banks"

and could not be expected to show much sympathy with or understanding of small enterprise.

In Detroit it would appear that the banks had largely abandoned to the accounts finance companies the financing of automobile and other customer paper and were in some cases recommending to small business applicants that they seek credit from the finance companies rather than from the banks themselves. This limited bank credit almost exclusively to the seasoned business concerns of intermediate and large size. At the same time, bankers complained that they were not making enough money, and banks were imposing service charges in order to increase their income.

Automotive parts, pattern, and specialty concerns occupy an important place in the Detroit manufacturing scene. These smaller concerns either sell their products to the larger ones or not at all. The independence of the small-parts concerns virtually exists in name only; in economic reality they are but contributing adjuncts to the great assembly plants, so much so as to raise the question as to why they have not been actually integrated. It appears that their "independence" has been preserved, because it has been more economical for the large automobile companies not to integrate them. The parts industry is one of seasonal operations and annual alterations. If integrated, the parts units accordingly would present an administrative problem to the assembling organizations. Further, by keeping alive a considerable fringe of "independent" parts makers in competition against each other, the central plants obtain their output quite as cheaply as though they owned them.

Some of these "independents," upon receiving orders for parts from the big automobile companies, were able, it was found, to discount their orders for cash with which to manufacture their product. In some cases, such cash was obtainable from a local bank; but a more frequent arrangement was for commercial finance companies to "buy" this paper, the financing charges largely eating up the profits of each order in advance. The following is a more or less typical case: A small concern making a patent brake had received a much-needed order for brakes from a truck-assembling company, which, in turn, had received a Government order for trucks. The brake manufacturer lacked cash to produce the brakes. Its attempts to raise money on the $7,000 order it had received were rejected by all Detroit banks on the ground that the Federal order to the original concern had the usual "escape clause," and because the small brake concern's financial position was weak. The manufacturer finally paid a finance company an initial fee of $125, received $5,250 in cash, paid 2 percent monthly interest on the $7,000, agreed to endorse and turn over to the finance company all checks received during the period of the transaction, and further agreed to assign all other outstanding accounts as security, with recourse in cash or in equivalent accounts if not paid up within 30 days. The concern was enabled to make the brakes, but what had seemed a profitable order became unprofitable because of the high costs of the finance company advance. [5]

A concern making dies for body manufacturers was in the fortunate position of not being affected by the cyclical fluctuations in automo-

[5] Under Michigan usury laws, the charges of finance companies may run as high as 30 percent in interest, service charges, and bonding fees. Chicago and Cleveland finance companies have their agents in Detroit, getting business on commission. These companies enjoy heavy profits from the local parts concerns.

bile production, as are most of the parts concerns, since the number of dies required is about the same whether the production is small or large. Its business, however, was seasonal, and its problem was to maintain plant from February to October and to finance peak production thereafter. Its managerial policy was to distribute its reserve in order to avoid taxation; then to finance the peak by borrowing. In so doing, it had found that no Detroit bank would advance money on its accounts receivable from either the Fisher, Nash, Hudson, or the General Motors units. One leading bank, according to the manager of this concern, had required that he show a 4-to-1 ratio in order to obtain a loan; but this was denied by the credit manager of the bank.

At the time of the study, this concern's receivables were being discounted or "purchased" by a finance company, which held a 20-percent reserve against "uncollectibles" despite the well-known names of the automobile companies involved. The assignment of accounts was confidential, but all checks had to be endorsed and turned over to the finance company. The interest rate, charged against the full amount, was 6 percent, computed monthly. In discussing the situation, the manager of this concern evidenced no complaint at these terms; in fact, he considered them favorable as things went in Detroit. He expressed the view, however, that signed orders, from concerns obviously sound and with national reputations, should be accepted for discounting as readily as actual receivables for orders filled. Requiring capital for plant modernization, he had considered applying to a large body concern for the investment, but had refrained in order to avoid the risk of becoming a virtual subsidiary of the latter.

Summary of 67 Case Studies.

Included in the Detroit study was a group of 67 business concerns. These included enterprises ranging from $9,000 to $1,000,000 in total assets, and averaging $46,000 in total assets. They had been in existence from 1 to 30 years. Two proprietors reported that they had recently filed bankruptcy proceedings. Of these 67 concerns, the proprietors or other officials of 55 stated that their business operations would be facilitated if a Federal credit institution were established and that they would utilize such an institution.

In 48 cases the need of additional equity capital, working capital, or credit was reported as being urgent. The amount of equity capital required was stated to be $775,200. The combined credit need of the 48 companies was $586,000, for periods ranging from 3 to 9 months, according to the cycles of their respective operations. The average equity capital required was $16,100, and the average credit need was $12,200. Operating economies of 2 to 5 percent on present operating costs were estimated if the equity capital could be obtained. Savings in interest costs of 4 to 15 percent were estimated if the credit need could be fulfilled and existing debts refinanced at maximum bank rates. Forty-seven of the 48 concerns showed total cash of $244,232, total receivables of $758,168, total payables of $923,623, and total loans of $221,992 (in addition to one Reconstruction Finance Corporation loan in the amount of $250,000).

Of the 48, 37 had been denied bank credit at one time or another, either quite recently or within the past few years; 14 had received some bank credit, though the amounts and the time arrangements were in many cases declared to be unsatisfactory. Twenty of these 37

concerns were being partly financed by finance companies. They were paying from 13 to 24 percent annually for this type of accommodation.

Some Specific Cases.

Among the case studies of small Detroit enterprises, the following are selected as illustrative of various conditions recurrently found:

A long-established concern manufacturing special fabric and towels for industrial cleaning and polishing purposes had enlarged its operation in 1937 by adding a rental and dry-cleaning service for such fabrics. With total assets of $142,000 at the time of the study, 70 employees, and a good record of profits, the company found that its inability to take advantage of trade discounts alone was costing it $200 a month and that its expansion required the employment of 7 additional men. Its line of bank credit had, however, been reduced within the last 3 years on the ground that its assets were not sufficiently liquid. A $6,000 credit line of long standing having been retired, the bank, when asked for a $5,000 credit line, had requested receivables as security, a plant mortgage, and a $5,000 personal note from the proprietor. This being declined, the bank recommended applying to a finance company. This was done; the finance company required a $60 bond or service fee, and made a 1-percent monthly service plus 6 percent annual interest charge. This was 18 percent annually on the money received by the business. The basic need of this concern was $15,000 to $20,000 working capital on a medium-term basis which the saving in discounts alone would appear capable of retiring.[6]

An industrial engineer, impressed with the value of an automobile accessory, bought the patent for $30,000, and, with $40,000 supplied by a partner, set up a small plant. Sales and profits proved good, and despite a set-back due to local strike conditions, at the end of the second year the business was able to show a 10-to-1 current ratio. Sales expansion being required, additional capital was sought. A wealthy Canadian backer was found who consented to endorse the proprietor's note in the amount of $60,000. While satisfied with the sufficiency of the endorsement, no Detroit bank would grant anything but a short-term loan. The deal accordingly fell through.

A long-established construction firm, specializing in the building of additions to factories, had experienced an almost total lack of such business for some time. Pending a business revival, income from leases of owned factory property was maintaining this firm in skeleton form. In an effort to enlarge this income by providing quarters for a new tenant, the firm had tried to mortgage for $10,000 a structure appraised at $75,000. Its bank had refused to take the mortgage, stating that it did not desire to hold security that would tie up its funds, or be taxable. The bank had, however, offered to lend $10,000 without tangible security, merely on the personal note of the head of this firm.

A sand and gravel company in a suburb had the opportunity to buy a fleet of trucks at the "distress" price of $18,500. Three Detroit banks declined to finance the transaction, though mortgage security as well as receivables of public agencies were offered. In the end, a small suburban bank advanced the sum on a note at 6 percent; the trucks were bought, and the note was retired within 1 year.

A long-established barrel-manufacturing concern, after passing through the depression, was forced to go through a settlement with

[6] See hearings before the Temporary National Economic Committee, Part IX, pp. 3883–3890: Testimony of Norman E. Gallagher.

creditors in 1935. Thereafter, it found bank credit for working capital unavailable. This was an extremely serious condition, since a barrel must be 65 percent paid for in cash by the time the staves reach the factory, whereas the proceeds from sales do not come for some time thereafter. The closing of two distilleries, which were steady customers, precipitated a further emergency. An enterprising plant manager, however, saw the opportunity to convert the business to the cleaning and renovating of used barrels and gradually shifted the plant's operation to this work. This change had apparently saved the day. No other plant in Detroit was renovating old barrels, and there was a demand for this service. Capital was sought to expand this operation, since orders were being rejected for want of resources; but no capital could be obtained. For each $1,000 in added renovating equipment, it was stated, 10 new men could be employed, this operation being 40 percent hand work. Further, a survey of the demand had indicated that an expansion from the 25 employees presently employed, to 250 employees, might be justified. The concern was currently obtaining some working capital from a finance company, which discounted its receivables on a 75-percent basis at 1 percent a month.

A small plumbing supply concern which had formerly been engaged in sizable operations, had been forced into bankruptcy in 1931. Since then, it had got along with little or no credit, banks having consistently refused loans because of the 1931 experience. Of late, an arrangement had been effected under which all its receivables were regularly assigned to a Detroit bank, the bank having given the head of the concern its power of attorney to collect such receivables. Under this arrangement (a variation of the "nonnotification" practice) if the bank were holding, say, $6,000 in receivables, the enterprise could draw about $1,000 for 30 days. Thus it was enabled to obtain a trickle of working capital. But recently a good-sized purchase of inventory at a 60-percent "distress" price had had to be abandoned because it could not be financed.

A potato-chip and shoestring-potato-canning manufacturer, starting from small beginnings, had experienced a 25-percent annual increase in business in each of the past 5 years; sales had reached $400,000 annually.[7] Since the potatoes and the cans had to be paid for in cash, working capital was perpetually short. In 2 months prior to the time of the study, $10,000 in prospective business had been turned down. The need was for $25,000 as medium-term working capital and $15,000 as permanent equity capital. This, it had been calculated, would effect 4-percent to 5-percent savings in total costs of production annually, and enable volume to be increased. Detroit's banks had refused the required aid on a number of occasions, the sole reason cited being their policy of granting only short-term credits.

A concern manufacturing insulation for residences, organized in 1930, had experienced both profits and expansion, but was unable to obtain necessary funds from either a bank, a factor, two credit companies, or the R. F. C., for the reason that residential construction itself is paid for on a long-term basis. A finance company, however, was extending some accommodation on the basis of receivables, charging for its services approximately 24 percent per annum.[8]

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[7] See hearings before the Temporary National Economic Committee, Part IX, pp. 3909–3913: testimony of Ernest L. Nicolay.

[8] Idem: Testimony of Edward J. Trinklein, pp. 3916–3922.

A concern manufacturing floor polish was caught with excessive inventories in 1937. Three banks had declined aid, and finance companies were resorted to; their high charges precipitated a situation where the Association of Credit Men took over the concern in behalf of certain creditors. A bank loan of $15,000 was then obtained by pledging $35,000 in receivables and subordinating the claims of certain creditors.

The representative of both this concern and the creditors' committee testified before the T. N. E. C.[9] that he personally knew of at least 25 Detroit companies in urgent need of credit and capital, with forced liquidation threatening if such aid was not forthcoming. In 1938, this witness testified, 35 liquidations were handled; in the first 2 months of 1939, 12 liquidations. "If financial assistance could have been obtained at a reasonably early period of time, a number of these businesses could have been saved."

MIDDLE WESTERN AREA: OMAHA, NEBR.

The basic source of consumer and business income in Omaha is agriculture. More than 80 percent of the population of the State resides outside of its two major cities. Of Nebraska's 1,400,000 people, Omaha has about 200,000 and Lincoln, the only other city of size, has 75,000. The farm population in 1930 was close to 600,000, occupying nearly 135,000 farms of 48,000,000 total acreage.

The Union Pacific Railroad, the meat packing industry, and manufacturing arising from agriculture, are important employers of labor within the city. At the time of the study, railroad operations were low as compared with predepression years and therefore the railroad was not contributing as formerly to the community. Nebraska livestock received by the packing plants was running 80 percent below the usual amount. Underlying both these conditions was the fact that 5 years of drought had created an estimated loss in the farm purchasing power of the State of $100,000,000 per annum. These conditions had exerted a marked effect upon the total volume of business.

The observations of one local businessman, the head of an electrical firm, serve to describe the situation. He observed that the farmer's order, which a few years ago would have called for an electrical installation amounting to $120, was now pared to a $40 installation; and that if his concern had done all the new installation work available in the city during the past year, it still would have operated on a part-time schedule. In general, the enterprises closely dependent on local consumer income were in a difficult position.

Manufacturing in Omaha.

Various forms of the processing of agricultural and livestock products are represented in the manufacturing field in Omaha, but 43 out of a total of 1,154 manufacturing firms of every class accounted for about two-thirds of all employment in manufacturing. These firms employed approximately 8,500 out of a total of 12,500 factory workers. The number of plants, however, was being reduced, partly because the city is at a marked disadvantage with respect to freight rates. The case of a local cough-drop company, with a national market and more than 100 employees, which had moved to Chicago a few months

[9] Idem: Testimony of Louis F. Davis, pp. 3965–3971.

before the inquiry, was cited repeatedly as an instance of this fact. This concern had moved its plant because it was cheaper to haul beet sugar from the western Nebraska beet fields all the way to Chicago on the through rate, than to deliver the beets at Omaha itself, nearly 500 miles nearer the point of production.

The Cash Basis in Enterprise.

Considering the depressed economic circumstances, a large part of small and intermediate business was found to be remarkably sound financially. This was explained by the fact that a very large percentage of existing concerns, both in manufacturing and in wholesale and retail trade, were long-standing establishments which had been conducted on policies marked by caution and conservatism. Concerns not so managed had tended to be shaken out in the past. The ability of conservative management to weather an emergency was being emphatically demonstrated in this community.

As a general practice, inventories had been held low, credit was conservatively extended or requested, and maximum liquidity was being maintained. Many firms invariably paid cash; trade debts were rigidly held down; and the ratio of both receivables and payables to volume of sales was markedly low. It is not too much to say that ordinary credit practices, especially in the relatively important lines of groceries and hardware, were to a large degree absent from the dealings between consumers and retailers and between retailers and wholesalers.

Jobbers and wholesalers were found to be making their collections from retailers weekly or semiweekly. In serving rural areas, Omaha's jobbers, making deliveries on Mondays and Thursdays, were collecting for each bill of goods on the succeeding trip. Similarly, wholesale and jobbing inventories were maintained at low volume. The outstanding characteristic of trade in this area was its constant relationship to the consumer cash supply. The refusal of business to incur the possibility of write-offs plus the saving of all trade discounts by going on a cash basis, emerged as the key to relative business health in this region.

It would be an oversimplification to state that this was a community without debt or credit. But, relative to other areas studied, this was the distinguishing feature. With the branches of nationally operated business concerns being financed by their parents, and the cash basis prevailing in local enterprise, Omaha as a trade center was in the market for commercial bank loans only to a minor extent. The principal credit problem was that of small manufacturers, with local markets; these experienced difficulties through slow collections and reduced volume. An attendant problem was that of small manufacturing firms which had undertaken to develop business outside this trade area; they had in some cases experienced an increase in expenses disproportionate to new volume of business obtained. These concerns largely constituted the demand for bank accommodation.

The Commercial Banking Situation.

Three banks serving general business at the end of the first quarter of 1939 showed deposits aggregating \$100,267,594. This was an increase of \$4,636,415 from the close of 1938. Their aggregate loans totaled \$25,768,318, or slightly more than a quarter of their deposits. Loans had increased but \$241,228 in this 3-month period. In contrast, three banks primarily serving the meat-packing industry showed

increases of $998,804 in deposits and $711,842 in loans. In a year's time, the total deposits of all Omaha banks had increased by $10,500,000, while loans had increased but $2,500,000.

Omaha banks were described as finding it particularly necessary to maintain liquidity because, of a total of $100,000,000 in deposits, about $92,000,000 represented demand deposits. The small balance of savings or time deposits was explained by the fact that the public had been widely educated to the use of building and loan associations for savings purposes; these had $45,000,000 in deposits compared to about $8,000,000 in time and savings deposits for the banks.

All of the above factors had entered into an admittedly conservative lending policy on the part of the banks. Banker judgment of risk worth, based on relative values as among different enterprises within the area, was inclined to impute managerial unwisdom and unsoundness to business concerns departing from the preponderantly cash basis or using credit even normally. Small businesses which were in a substantially frozen position were regarded as being outside the scope of bank risk. In discussing the policy underlying the extension of short-term credits, bank executives freely acknowledged both a considerable percentage of outright rejections and the granting of numerous loans for amounts smaller and periods shorter than requested. The distinction between loans for working-capital purposes, and those for purposes of investment or refinancing, was sharply drawn and "capital loans" were denied.

However, the low volume of commercial loans was due not only to the exercise of caution on the part of the banks but also to the lack of demand for loans by the smaller enterprises.

A further factor which served as a deterrent to bank credits was the existence of a group of concerns embarrassed by large, slowly moving inventories and frozen receivables. They were operating on a hand-to-mouth basis with respect to cash with which to pay overhead and meet payrolls. These companies were able to qualify for little, if any, bank credit. They were also unable to discount their bills, and were in arrears on current payables. Constituting a considerable source of employment to the community, their plight led to further analysis.

Ten such companies were studied. Their consolidated condition follows:

ASSETS		LIABILITIES	
Cash	$13,462	Accounts payable	$150,863
Accounts receivable	161,065	Bank loans	9,599
Inventory	266,754	Notes payable	41,371
Total assets	441,281	Total liabilities	201,823

The percentage of bank loans to total payables was 4.8 percent. The corresponding trade percentage of payables was 75.

The companies in this group suffered most because of their inability to discount bills receivable at the usual commercial bank rates. Instances were observed in which that difficulty alone spelled the difference between an operating profit and loss. Finance companies dealing in receivables were found to be profiting from the inability of these concerns to deal directly with the banks.

A typical case follows: A $25,000 corporation wholesaling radios, refrigerators, and various household appliances applied to a finance company. Its receivables were attested by the usual customer-signed paper and, furthermore, represented sales of semidurable goods.

The finance company first required an annual fee of $100. Next, a flat charge of 1 percent on the total value of receivables "bought." Next, an agreement requiring the company to buy back any pledged receivables not liquidated within 60 days, or to substitute an equivalent amount of acceptable receivables. Next, various additional fees and service charges on particular transactions. Finally, an interest charge of 6 percent on the money actually advanced. In return, the finance company supplied cash which rarely exceeded 50 percent of the total value of the security (or "purchase") in receivable paper.

The manager of this wholesaling concern produced tabulations for 1938, showing that the money received from the finance company had cost him 15 percent. Since the receivables discounted were of the best, and could have been collected in due course by the wholesaler, it is significant that the financing costs were almost exactly equivalent to the net loss sustained on a business volume of about $180,000 for the year. This company was in the midst of moving to less expensive quarters, reducing pay roll and curtailing inventory. It had abandoned its dealings with the finance company, being enabled to do so because a trade creditor permitted him to carry a considerable stock on consignment.

The Problem of Succession.

A number of long-established concerns in Omaha had developed a problem, peculiar to small proprietary enterprise, in regard to replacement of managerial personnel. Elderly proprietors, who had conducted their own businesses successfully for 25 to 40 years, were in some cases unable to retire because they could find no one to take their place.

This situation was affecting the credit rating of these establishments, despite their long records of successful dealings, with the result that some were no longer finding credit available at the banks.

The number of such old-established enterprises in Omaha served to draw attention to the significance of this succession problem in relation to small-business credits, especially long-term credits. Bankers with whom the situation was discussed pointed out that, while a loan to an owner-managed enterprise might be based upon tangible collateral, its repayment was affected also by the managerial ability, and the life-expectancy of the proprietor.

Those with whom the problem was discussed appeared to have given little or no consideration to possible solutions of the succession problem, such as a regularly established system by which employees could be financed to take over such enterprises on a cooperative basis, or by which creditors could be assured of some other systematic method of business continuance under competent supervision. It was rather taken for granted that a proprietor's impending retirement or death would damage the credit status of the enterprise with which he had been identified and jeopardize its actual survival.

Omaha's Community Business Fund.

A community effort to meet the local capital-credit situation had been made by the Omaha Chamber of Commerce by setting up a corporation for that purpose. This corporation had a capital of $60,000 raised by public subscription. The Omaha Industrial Development Co., as the organization was known was initially organized to bring new enterprises to the city. Later, its efforts were directed to the

TABLE 24.—*Dividend disbursements expressed as amounts and as percentage of income available for dividends, for a sample of small baking, men's clothing, furniture, stone and clay products, and machine-tool corporations, 1926–36*—Continued

STONE AND CLAY PRODUCTS—Continued

Percentage of economic income available for dividends	Number of firms and amount of dividends reported paid for year—										
	1926	1927	1928	1929	1930	1931	1932	1933	1934	1935	1936
Companies with economic income—Continued.											
50 to 74.9 percent:											
Number of companies	1	7	7	3	1	1		2	3	5	3
Amount	$500	$45,424	$90,880	$14,953	$2,790	$4,500		$2,500	$29,698	$57,965	$27,032
75 to 99.9 percent:											
Number of companies	5	2	4	2	5	2				3	10
Amount	$50,900	$20,000	$61,628	$5,977	$45,455	$7,000				$6,547	$210,149
Subtotal, 0 to 99.9 percent:											
Number of companies	15	14	16	8	9	3		4	6	13	20
Amount	$128,199	$131,706	$171,054	$36,356	$57,000	$11.500		$3,057	$39,903	$77,889	$255,014
100 to 124.9 percent:											
Number of companies	2	4	4	3	2	1	1		1	1	5
Amount	$6,500	$115,340	$171,606	$51,000	$6,000	$2,000	$3,930		$2,500	$3,500	$54,536
125 to 149.9 percent:											
Number of companies	2	4	1	1		1	1		2		1
Amount	$14,000	$36,540	$10,000	$15,000		$4,000	$10,093		$5,058		$8,125
150 to 174.9 percent:											
Number of companies	1		1		1	1	1	1	1		1
Amount	$53,504		$20,000		$6,360	$16,068	$5,000	$5,192	$2,000		$8,000
175 to 199.9 percent:											
Number of companies	1	1	1				1				
Amount	$22,400	$122,650	$40,560				$2,998				
200 percent and over:											
Number of companies	13	7	4	6	6	7	3		4	2	
Amount	$205,898	$149,783	$40,262	$77,476	$59,121	$120,425	$16,007		$16,415	$5,500	
Subtotal, 100 percent and over:											
Number of companies	19	16	11	10	9	10	7	1	8	3	7
Amount	$302,302	$424,313	$282,428	$143,476	$71,481	$142,493	$38,028	$5,192	$25,973	$9,000	$70,661
Total:											
Number of companies	34	30	27	18	18	13	7	5	14	16	27
Amount	$430,501	$556,019	$453,482	$179,832	$128,481	$153,993	$38,028	$8,249	$65,876	$86,889	$325,675
Companies without economic income—											
Paying dividends:											
Number of companies	7	6	10	9	14	15	14	7	5	3	4
Amount	$88,057	$26,920	$79,743	$66,700	$82,201	$29,462	$57,025	$9,718	$6,181	$2,288	$5,363
Not paying dividends:											
Number of companies	76	83	57	58	95	105	113	101	84	67	47

MACHINE TOOLS

Companies with economic income—											
Not paying dividends:											
Number of companies	85	69	84	80	37	30	10	28	45	54	37
Paying dividends of:											
0 to 24.9 percent:											
Number of companies	4	6	6	13	1	1	1	5	5	6	6
Amount	$8,668	$19,848	$20,721	$69,896	$2,000	$641	$250	$4,922	$7,134	$14,558	$4,543
25 to 49.9 percent:											
Number of companies	4	5	6	10	5	2	1	1	2	5	4
Amount	$49,006	$33,902	$24,741	$153,206	$34,291	$2,145	$1,000	$1,000	$12,800	$18,651	$45,867
50 to 74.9 percent:											
Number of companies	5	4	6	9	2				1	3	5
Amount	$45,250	$31,450	$62,950	$51,921	$3,040				$1,000	$57,900	$114,593
75 to 99.9 percent:											
Number of companies	4	2	4	4	2	4		1	2	2	11
Amount	$42,500	$11,000	$31,350	$105,138	$9,200	$22,017		$23,500	$33,000	$5,240	$85,261
Subtotal, 0 to 99.9 percent:											
Number of companies	17	17	22	36	10	7	2	7	10	16	26
Amount	$145,424	$96,200	$139,762	$380,161	$48,531	$24,803	$1,250	$29,422	$53,934	$96,349	$250,264
100 to 124.9 percent:											
Number of companies	3	1	3	1	3	2			2		8
Amount	$37,212	$1,500	$30,976	$19,140	$114,128	$73,000			$10,175		$96,049
125 to 149.9 percent:											
Number of companies	3	2	1	2	1	3	1			2	4
Amount	$18,093	$2,956	$30,000	$24,800	$3,818	$5,595	$6,200			$7,726	$24,665
150 to 174.9 percent:											
Number of companies	1			2	1	1		1	1		2
Amount	$9,030			$3,790	$30,000	$7,000		$2,670	$3,300		$50,631
175 to 199.9 percent:											
Number of companies		2			2		1	1			
Amount		$9,766			$5,407		$1,125	$1,750			
200 percent and over:											
Number of companies	6	4	3	3	12	2	2		1	3	4
Amount	$71,811	$77,290	$35,135	$62,552	$107,163	$32,500	$12,000		$1,500	$11,366	$37,041
Subtotal, 100 percent and over:											
Number of companies	13	9	7	8	19	8	4	2	4	5	18
Amount	$136,146	$91,512	$96,111	$110,282	$260,516	$118,095	$19,325	$4,420	$14,975	$19,092	$208,386
Total:											
Number of companies	30	26	29	44	29	15	6	9	14	21	44
Amount	$281,570	$187,712	$235,873	$490,443	$309,047	$142,898	$20,575	$33,842	$68,909	$115,441	$458,650
Companies without economic income—											
Paying dividends:											
Number of companies	3	5	1	1	21	18	14	5	6	4	4
Amount	$3,472	$76,085	$875	$1,771	$194,389	$55,979	$38,177	$1,334	$1,953	$3,922	$7,515
Not paying dividends:											
Number of companies	67	75	50	35	101	116	142	122	91	70	56

plaint to make on the score of losses through direct small-business loans.

Four manufacturers of mining machinery, supplying and installing mining equipment throughout the region, were generally extending trade credit for such equipment, on varying terms. This credit was extended more on the characters and abilities of the mine operators than on property appraisals. Only one such concern used engineers to check the mining properties. Its terms were usually 50 percent cash on acceptance of the order and 50 percent on completion of contract, or in any case within 120 days. One concern allowed as much as 6 months time.

All had experienced some losses; all favored the medium or large operator as against the small.

Some Denver case-studies.

A small trucking concern, with 20 trucks, had made and repaid previous bank loans of $2,000, $1,000, and $500; but had sold out because it was unable to finance on a long-term credit basis the purchase of needed modernized equipment.

An auto rental concern, enjoying good profits, had been able to expand largely because it could borrow $20,000 from a finance company at a cost of 1 percent per month on the unpaid balance. It also had a bank loan at 7 percent. It was compelled to resort to a finance company because its bank would not grant a larger loan, although the business was adequately repaying both the bank and the finance company.

A distributor of motor trucks and small automobile busses, with sales exceeding $200,000 in the 6 months preceding the inquiry, was in need of working capital. This distributor had to buy his vehicles on a strictly cash basis from the automobile manufacturer. The concern had received an order for three busses, requiring $12,000 in cash, and although there was no outstanding bank indebtedness, the banks had refused to advance the sum, despite the fact that the buyer was the local traction company and had agreed to pay cash 15 days after delivery. The distributor was compelled to borrow the money elsewhere, paying $150 for the use of $12,000 for 4 days. The traction company at the time of the study had offered to purchase 40 more busses; but the distributor did not know how to raise the required $160,000 in cash to consummate the deal.

A lumber company, selling lumber exclusively to mines, was usually paid by its coal mine customers in coal. Accordingly, it had formed a coal company to market the coal. This was done at a profit. But the lack of working capital reduced this profit because each transaction consumed an unusually long time. The final result was that the lumber company did not get its cash for the better part of a year after the timber was cut. The coal company's $1,500 line of credit at a local bank was not enough to relieve this situation. The management stated that $5,000 working capital, on a 1-year basis, would enable it to employ 8 or 9 more men and finance an enlarged operation. Under its present circumstances it was compelled to reject additional business.

Of two pickle concerns, one was financed by a country bank which extended credit liberally but charged 8 percent; the other borrowed smaller sums in Denver at 6 percent. The former had doubled its sales in 2 successive years and was rapidly taking on new sales

territory; the latter, too, was expanding, but the Denver banks were unable to furnish on the basis of its financial position adequate additional credit for expansion.

A wholesale heating and plumbing-supply firm had commenced operations during the depression. It inherited the debts of its predecessor which included a $37,000 bank loan. A small but consistent profit had been made each year, but capital was lacking to develop existing opportunities in industrial construction, in public buildings, and in farm-modernization work. Although one Denver bank was extending ample working capital, on a short-time basis, the concern was in need of long-term credit.

A wholesale beverage distributor was being financed by a brewery for which it distributed beer. In this business, a complete turn-over of inventory every 10 days was required in order to keep up with overhead costs. This period could be lengthened and the business stabilized by extending into other fields, but capital for such extension was lacking. Either equity capital or long-term credit was required.

As an illustration of the constructive attitude of one local bank, the head of a wholesale electric refrigerator and radio concern narrated the following: After some years of successful operation, his business became embarrassed in 1932. The bank called in all loans. He was unable to pay. However, officers of the bank, instead of closing him down, sat down with him to reorganize the business methods of the firm. This was done and the business continued. "It was the best thing that ever happened to me;" said this operator. Officers' salaries and withdrawals were reduced, a plan of field warehousing and borrowing on warehouse receipts was worked out and systematized. This concern had now attained a net worth of about $70,000.

A manufacturer of neon signs sold his product to business houses and auto camps on terms running for as long as 2 years. But it was necessary for him to finance these accounts. Until recently the banks would not discount the paper of his accounts. He was, therefore, forced to deal with finance companies, paying interest of 10 to 12 percent for the loans. The finance companies required, as collateral, receivables in twice the amount of the loan as a reserve against uncollectibles; although the actual amount of uncollectibles for 1938 had been $447 out of a total volume of $45,000, or under 1 percent. The banks were now extending a credit line up to about $10,000. While this was insufficient to refinance the former debt, it had the effect of causing the finance companies to reduce the interest rate to 8 percent. A term loan at reasonable interest, sufficient to liquidate these costly loans against receivables and to finance future sales, had been sought, but without success up to the time of the inquiry.

A small music company engaged in the business of equipping school bands with instruments was started with a capital of $600. Its business has been profitable, its net worth being in excess of $40,000; its management stated that this was a good field for small business in that a small music company pays no more to the instrument maker than a big concern and, moreover, has less overhead. The founders of this business had lived on starvation withdrawals and put every possible cent of earnings back into expansion. Now they were being aided by a bank arrangement under which each month's projected

expenses were borrowed in advance on a note basis, and repaid as money came in, the interest being figured daily on the unpaid balance. By this means it did not have to discount its receivables, which were relatively heavy.

A maker of jelly, and other fruit specialties, was financed entirely by the cold-storage concern with which it stored its unpreserved fruit. It was paying the cold-storage company 7 percent on sums borrowed for buying supplies, as well as storage charges for such supplies. At times, the cold-storage company had advanced as much as $87,000 in cash to this concern.

A manufacturer of a cleaning fluid of his own invention found that his product had a wide market in the nearby retail outlets. Desirous of extending the range of his market, he had been unsuccessful in obtaining a loan from either the banks or insurance companies. He stated that his product had made its way without advertising against a competing product whose advertising cost $350,000 a year, and commented: "The banking system is of little help in a situation of this sort. We must try to develop some other way of obtaining assistance."

The owner of an unincorporated retail shoe business, with five stores, had been able to obtain short-term bank credit by pledging his life insurance policies. By reducing inventory and closing an unprofitable store, he had succeeded in putting his business in shape so that bank credit was no longer required.

Concerns Financed by Manufacturers.

An auto-supply company with a sales volume in 1938 of nearly $300,000 was financed mainly by large manufacturers of accessories, which supplied the concern with its inventory and withheld the billing for considerable periods, usually until after the tourist season closed. This enabled the company, which itself extended maximum credits of 30 days, to sell the goods before having to pay for them. A small line of bank credit was carried for emergencies, but the inventory received on credit amounted to nearly 10 times as much as the bank loan.[10]

A rural blacksmith shop, essential to a considerable farming area, had been purchased for $5,000, which was to be paid monthly at $50 per month. Expenses were running from $65 to $100 a month, income averaging $275. The blacksmith could find no facilities for financial aid—the A. A. A. having no classification into which his situation filled, and the F. H. A. having declined a loan. Coal was being bought by the sack, owing to lack of cash to buy it in larger lots. The blacksmith said that a $1,000 "capital loan" would supply a needed electric welder, would enable him to hire another man, and furnish a used truck with which to visit the farms.

A small-town telephone exchange, owned by a local man, had 185 telephones, 145 miles of single line, 1,200 feet of underground cable, and a connection with the central phone utility from which it derived commissions on calls. Revenues were $2,400 annually. A rural bank had loaned $175 at 8 percent, a private individual $1,600 at 8 percent, with principal payable $20 monthly. This phone system was operated by its owner; it employs a relief operator and a part-time lineman. Its owner stated that with $4,000 of additional capital

[10] In this connection, one wholesale drug company complained that large national drug supply concerns had been known to pay up the indebtedness of rival wholesalers, in order to obtain their outlet services exclusively.

he would be enabled to expand his service to 400 phones without building any new lines; retire the present debt, and repair the switchboard.

In 1932 an experienced fur salesman went into business for himself and succeeded in building up his business to the extent that the annual sales volume and fur repairing had reached $25,000. He also acquired a one-third ownership in a silver-fox farm, and employs 14 workers in his business. Credit, however, has been lacking. This enterpriser believed that with $4,000 of new capital he would be able to increase his volume of business by four times, and employ six additional people.

A company manufacturing tire relinings and patches, and utilizing rubber scrap and waste, was loaned $2,350 by a local bank to retire certain payables and consolidate others; the interest was 8 percent, payments on principal being at the rate of $100 monthly. The security on the loan was a chattel mortgage on machinery and equipment having a depreciated value of $6,000. On two small personal loans, the owner was paying 2½ percent and 3 percent a month, respectively. Sales were mainly to established chain stores and mail-order houses, but since these receivables could not be discounted the company was continually short of cash. The concern had had to borrow repeatedly from individual sources in order to finance its supplies. The owner stated that he had paid as high as 5 percent a month to a "loan shark."

PACIFIC NORTHWEST AREA: SEATTLE, WASH., AND PORTLAND, OREG.

The Pacific Northwest includes the Columbia River Basin, second largest watershed in the United States and most varied in its natural resources; and the Puget Sound coastal belt, the Nation's outstanding lumber region. The principal industries of the region are lumbering, salmon fishing, varied agriculture, and small manufacturing. While mining has potential importance it was quiescent at the time of the study. The tourist industry, based upon sea, forest, and mountain attractions difficult to surpass, was but partially developed.

The principal cities of the region are Seattle, Wash., with a population of 356,000 in 1930; Portland, Oreg., with 302,000; and Spokane, Wash., with 116,000. The first two communities have excellent seaports and are the most closely adjacent of all coast ports to the Orient, and to Alaska. Spokane has an "inland seaport" relationship to the mountain mining and lumbering area to its east, and the upland desert at its southwest is shortly to be irrigated from the Grand Coulee project.

This region had in the past been characterized by the predominance of a few great industrial groups—lumber, railroad, shipping, the utilities. But these had either waned or were showing signs of waning. The drift seemed to be in the direction of new and more varied industries, operating through small- and medium-sized business units of local origin. The existing prosperity was being contributed at the time of the study quite as much by the new industries as by the old, and the outlook for local enterprise, to judge by regional potentialities at least, might be termed good.

But capital was slow to come forth. It was not, in the strict sense, lacking; for within the region itself were stores of capital derived from the large operations of the past. However, small- and intermediate-

sized individual enterprise, striving to take over and support the economy, was handicapped by its inability to finance itself.

The Waning "Big Business" Base.

The Northwest was developed and heavily exploited for years by great railroad, shipping, fishing and lumber interests. The first of these to decline were the railroads. Next, shipping, affected by foreign and other nonregional conditions, had largely disappeared. The fishing industry is still active; and although lumbering at the time of the study was still the largest single contributor to regional employment and income, the industry had experienced a combination of unfavorable conditions, including its own failure to conserve its capital asset—timber. Apparently the latter is in for a long and painful period of liquidation. Its spokesmen were highly pessimistic, blaming labor, Southern and Canadian competition, foreign governments (and our own) for its low volume of sales and high fixed charges and operating costs. One of the basic reasons for the trouble is that the forests have been "mined." The industry was following the policy of cutting and selling its remaining timber holdings to retire its bonded debt, and quitting when the timber was gone. A temporary revival of markets would, presumably, only speed this liquidation process.

In the liquidation, certain companies (designated below by letters) were due to outlast the others, as may be seen from the following table of estimated timber acreages remaining to the principal private owners:

	Acres		*Acres*
A	794, 000	E	121, 000
B	740, 000	F	86, 000
C	166, 000	G	86, 000
D	128, 000		

There are, moreover, 16,499,142 acres in Oregon and 11,176,624 acres in Washington in the national forest system. Logged on a replacement basis under Federal control, these forests will maintain a considerable lumber activity for this region in perpetuity, though not on a scope comparable to the timber-cutting heyday of former years.

The electric utilities, which to some extent had inherited the dominant position of the older big industries, were not contributing greatly to employment, inasmuch as the power industry is not a large employer except during periods of construction.

The Bases for New Developments.

In the case of Fall River, Mass., when the textile industry declined, small enterprises from other sections were deliberately imported in an attempt to take up the stock. In the Northwest, the community leaders were striving primarily to develop new industries of local origin, depending upon regional assets to attract the immigrant type of enterprise automatically.

The resources of the region would appear to justify this approach. Natural assets for a development adequate to support many times the present population are undoubtedly present. Climate and soil fertility foreshadow a great expansion of the present varied agricultural and animal production. Mineral assets [11] are valuable. Practically

[11] Known mineral deposits include antimony, arsenic, bismuth, chromium, cobalt, copper, gold, iron, lead, manganese, mercury, molybdenum, nickel, platinum, silver, tin, tungsten and zinc; also considerable lignite deposits with limestone, phosphate rock, sodium salts, diatomaceous earth, various clays, and building stone. Mining would be prevailingly a small unit or medium-unit operation.

everything necessary for diversified manufacturing exists. Transportation, on the other hand, constitutes a problem.

Greatest of assets for all types of indigenous development is the partly finished Federal "harnessing" of the Columbia River, for irrigation and hydro-electric production. Bonneville Dam, on the Columbia River above Portland, is finished and ready to produce cheap and abundant power, but Portland was not yet utilizing that power at the time of the study.[12] The ultimate Bonneville capacity is 576,000 horsepower; initial capacity, 115,250 horsepower. Further up the Columbia, in the interior, the Grand Coulee Dam, largest of man-made structures, was nearing completion; it will ultimately develop 1,890,000 kilowatts of energy, irrigate 1,200,000 acres of what is now desert land, and support 25,000 to 40,000 farm families. These are but the initial units in what is planned as a Federal project larger even than T. V. A.

Seattle, as the port of nearest contact with Alaska, looks to the future development of that vast territory, one-fifth the size of continental United States,[13] as bearing heavily upon its own future. Today, there are only 60,000 persons in Alaska, or one person to every ten square miles. In climate and in other respects, Alaska is comparable to Norway, Sweden, and Finland, which support respectively 22.6, 39.6, and 27.3 persons per square mile. Alaska is richer than Europe's northern nations in all minerals including gold, copper, iron, platinum, tin, mercury and other metals; it has petroleum, timber, woodland and pasture, as well as farming potentialities. Of 2,800,000 horsepower in potential electrical development, Alaska today has but 50,000 horsepower developed. Held back by climatic factors—which in fact are no worse than those of Sweden, Norway, and Finland, or of some States in the United States—and by bad transportation and high living costs that are in turn due to its undeveloped condition, Alaska is being overlooked by those who say "America's last frontier is exhausted." Only capital, plus individual initiative are needed to develop this area, considered by some to be capable of supporting 10,000,000 people. Seattle has many Alaskan enthusiasts, but capital for the tremendous venture is completely lacking.

Manufacturing.

According to the 1935 Census of Business, Washington had 2,877 manufacturing enterprises and Oregon 1,722. These were mostly small, their average value of product being about $160,000, and produced a variety of products. Among those were: wood products, furniture, and paper and pulp products, as the largest groups of all; food products, including the canning and preserving of vegetables, fruits, and fish, meat packing, flour, and dairy products; cereals and feeds for livestock, insecticides, sprays, fertilizers, and sundry farm equipment; men's and women's garments, shoes, and hats, from the types used in Alaska or in lumbering to ordinary work clothes, outing garb, and women's clothes of style; sporting goods; printing and publishing; chemicals, abrasives, and various metal products; machine shop and foundry products. The region's construction industry was substantial, but shipbuilding was temporarily inactive.

Although the number of manufacturing units in 1935 was about the same as in 1931—12 less in Washington and 23 more in Oregon—

[12] Since this study was made, a large aluminum concern has announced that it will build a plant near Portland, to be operated by Bonneville power.
[13] See report, The Problem of Alaskan Development, Department of the Interior, August 9, 1939.

manufacturing employment had gained from 70,849 to 81,780, or 15 percent, in Washington; and from 42,180 to 52,216, or 26 percent in Oregon. The increase in the value of products was approximately 16 percent in both States.

The Need for "Capital Loans."

For purposes of this report, 124 nonretail enterprises were studied. Of these, 65 were in Portland, 54 in Seattle, and 5 in Tacoma. Information regarding Spokane enterprises was obtained subsequently.

Of the 124 establishments, 45 declared they had no special financial needs at that time. Their credit relations were satisfactory, and they had accumulated reserves. Only 6 of the 124 complained of inability to obtain short-term working capital (for 60 to 90 days) on satisfactory terms. Working capital was quite generally furnished by the banks, and, with the above exceptions, the situation was declared to be satisfactory. It is significant that the high-rate finance companies were much less developed in this region than in others covered by the survey.

But 45 concerns voiced an urgent and immediate need of financing for new machinery, added equipment, and the development of new devices. All of the 45 declared that they preferred to obtain the needed capital on a loan basis, rather than by selling equities or taking in partners. Ten of these companies had rejected offers that would have brought new partners into the business or otherwise impaired their personal control. All 45 considered that their business prospects justified long-term loans and complained about the banking situation in which the "capital loan" was denied.

The capital loans desired by the 45 concerns were small. One was as low as $800; the others ranged from $1,500 to $25,000. Credit worth was not generally the issue, for these concerns appeared to be credit worthy. The difficulty centered on the fact that the banks of the area did not make capital loans. Upon inquiry it was found that at times banks used the term "capital loan" with different meanings, or applied it differently to specific applicants. Investments in plant or other capital outlays, if not made out of retained earnings, was a capital loan (i. e., more appropriate to equity financing). On the other hand, the loan for refinancing purposes was also regarded as a capital loan. In one case, for some years a small manufacturer had borrowed up to $5,000 working capital annually and paid it back within the year. This manufacturer had been unable to retire the credit entirely in 1938; the bank demanded immediate payment of the balance (and discontinued the earlier arrangement) on the ground that the overdue advance of working capital had now become a capital loan. By and large, the banks were prone to regard any loan for longer than 1 year as a capital loan.

Among the 124 enterprises, 8 wanted term loans in order to save interest costs through the consolidation and refinancing of existing scattered debts. These, a minority, were dealing with finance companies, either by pledging receivables or on a mortgage basis. Some also had incurred heavy trade credits for machinery purchases.

Finally, 15, mainly in the wood-processing and garment lines, were in such poor financial condition that liquidation was either contemplated or seemed warranted. This was slightly over 8 percent of the total number.

Small business in this region was especially desirous of obtaining its capital in loan form rather than through the sale of minority equity interests. The reason was plain: These small businessmen were determined not to forfeit control as the price of growth. Taking in "junior money" might spell the end of running one's business in one's own way. Finally, with great Federal power projects under way, and Alaskan development on the horizon, the established small businessman in this region generally regards signing away any portion of his share in tomorrow's growth as undesirable.

Seattle: The Banking Situation.

Seattle banking has, in the past, been too closely identified with railroading and lumbering to have had much interest in financing small enterprise. This situation was being altered, however, largely as a result of competitive factors. First, one liberal bank, with "new blood," had begun to increase its commercial loans and extend credit on terms favorable to the small applicant; other banks had to some extent followed suit. One with $25,500,000 in deposits, had $10,934,000 in commercial loans outstanding at the time of the inquiry—in excess of 40 percent. Another, with $23,200,000 deposits, had $8,000,000 in loans; and a third, with $76,000,000 deposits, had nearly $25,000,000 in outstanding loans. Total deposits in Seattle banks were $294,300,000; total loans, $98,445,000. The remainder was mainly in cash and "Governments," with but $6,000,000 in industrial securities.

In the case of at least one bank, lumber paper was a heavy item; and in all, the loans were mainly short-term. The banks were handling automobile paper, commonly the finance companies' mainstay, which together with the banks' liberal lending policies, was mainly responsible for the fact that the finance companies had hardly gained a foothold in Seattle. One neighborhood bank did a large business in personal loans, in many cases to business enterprises.

Although the long-run business prospects in Seattle appear to be sound and the banks are much more liberal toward small enterprises than they used to be, the institutional limitations of commercial banking still stand in the way of an adequate flow of needed funds in the direction of small business. A liberal Seattle banker was asked the following question: "Can you name any small business enterprises which you have examined and believe to be worthy of credit, but whose applications for loans you have nevertheless been compelled to reject?"

A list of seven such enterprises was furnished without hesitation, five of which were studied with a view to determining, in each case, the factor or factors responsible for their inability to obtain bank credit. These cases illuminate some of the inherent difficulties of the commercial bank in meeting the financial needs of small business:

A. An established Seattle businessman, who had specialized for some years in the salvaging of waste and the recovery of commercial products from waste, often using original methods and apparatus of his own invention, decided to establish a plant at Ketchikan, Alaska, for deriving meal and oil from the fish waste of the salmon canneries. Many tons of such waste were dumped daily into Ketchikan harbor with the loss of iodine and vitamin-rich materials valuable for stock feed, as well as creating a health and navigation problem. Initial

capital of $25,000 for the venture was obtained by the pledge of business assets in Seattle and Portland and through small personal loans. Of this $12,000 was expended upon initial construction and lost when the Forest Service canceled a permit previously granted. The project was saved through the granting of a personal loan of $4,000 by the head of a small bank in Ketchikan, a $4,000 mortgage on the proprietor's home, and a $6,000 loan against machinery. A new site, including an excellent small harbor, was purchased. A plant was constructed and operations were begun on a small scale in 1935. These proved profitable, but a second difficulty arose when the town of Ketchikan passed legislation forbidding the canneries to dump further salmon waste into the harbor. This amounted to a compulsion upon the new plant to handle all the waste of the 13 nearby canneries, which it was not equipped to do, and the need for expansion to meet the new demands placed upon it have embarrassed the enterprise ever since.

In the first 5 years of its operation, the plant's entire production was profitably sold and all its profits were plowed back into the business, not a cent having been withdrawn by the proprietor. At the time of the study, the situation was such that all the fish-waste of Ketchikan harbor could be handled; a single good year would retire the bulk of the debt; and a demand by a single major creditor would go far toward bankrupting the enterprise. The need was for the consolidation and amortization of a $25,000 indebtedness on a three-year basis. No Alaska bank could undertake this refinancing; the Seattle banks regarded the enterprise as outside their territory and in addition were not making capital loans. The R. F C. had declined to refinance a debt incurred through past expansion. Credits from different nonbank sources—food and other supply houses, machinery concerns, an oil broker, and the Seattle enterprises owned by the proprietor—although not large, was a source of constant embarrassment. This original-minded enterpriser had no desire to sell an equity in a business which, once launched, might conceivably spread to other Alaskan canning centers and grow to large proportions. Tests had shown that an added investment of a few thousand dollars in refining equipment would develop a medical product which the United States today imports largely from abroad.[14] But capital could not be obtained.

B. A building-supply firm with seasoned management and a 30-year successful record in Seattle, was refraining from bidding on large-sized jobs because it could not obtain the needed financing. This situation arose from the existence of an unusually long collection period in the building industry, where payments to the supplier average 90 days, and, in the case of government work, 6 months. The large manufacturers of building supplies, on the other hand, were increasingly demanding cash in 30 days, and were offering a 4-percent discount for cash. But this company often could not take advantage of the discount. "We spend about 20 percent of our time worrying over financing," stated the manager. Some short-term working capital was supplied by banks which accepted the assignment of receivables and charged 6 percent on unpaid balances, but sums so obtained were insufficient for pay roll and other working purposes.

[14] See Hearings before the Temporary National Economic Committee, Pt. IX, pp. 3983–3993, testimony of Willis H. Lebo.

This concern was "buying itself" on a long-time basis from the former head, who had retired from the business. It was doing this from operations, and, moreover, was earning some surplus. But it could not stabilize or extend its operations because the commercial banks were unable to allow for the time discrepancy between its compulsory prompt payments and the concern's somewhat tardy collections.

C. A school-supply concern, selling textbooks and other types of school equipment, had increased its volume from $22,000 in 1934 to $45,000 in 1938. It was virtually an adjunct to the school system, and its receivables, being those of the State government, were "gilt-edged." But the banks would not accept these receivables because a State law, as interpreted by the courts, required supervision and collection of each individual item of assigned accounts. An individual banker had accepted these receivables up to $17,000, charging 10 percent, later reduced to 8 percent. A finance company had financed some receivables, at the rate of 14 percent.

D. The manager of a well-established typewriter and office machine sales and service business had invented and patented a paper-grip feed roll, applicable to any typewriter. In 1935, one large typewriter parts concern purchased 2,670 of these devices; in 1936, 7,010; 1937, 27,050; 1938, 27,960; January to May 3, 1939, 8,000. The inventor attempted to obtain a loan of $2,500 for machinery, $1,000 for sales promotion and $1,000 for raw materials. Despite the existence of a market for his product, he had been unable to do so. The net worth of the business was not regarded as adequate for the loan; besides, the bankers considered this to be a capital loan. Here, the need appeared to be for equity capital.

E. A skilled mechanical engineer, formerly retained by the General Electric Co. for experimental work on small Diesel engines, became chief mechanical engineer at the Bremerton Navy Yard and continued his experiments, developing a small marine engine suitable for use by the fishing fleet. Later, he succeeded in organizing a company for the development of this engine. Over a period of years $77,000 was earned and was largely plowed back into the business. In 1937, additional capital was added through the entry of a partner. At the time of the study, many local fishing boats were using this engine and a fisheries-supply concern had offered to contract for 20 engines a year. The company's assets included machinery, $17,000; patterns, $12,000; jigs and dies, $8,000; stock parts and receivables, $3,000, or a total of $40,000. The liabilities included accounts payable of $2,000 and a balance due on a mortgage obtained from a local bank amounting to $1,650, reduced from $3,000. The needs of this company were $30,000 for increased production facilities and $15,000 to $20,000 for long-term working capital. But here, again, the commercial bank can be of no assistance.

A sixth Seattle case was that of a small concern which, upon making a few shuttlecocks for the game of badminton on special order, found that only one other concern in the nation was making this product and accordingly shifted its operations. It developed a large annual volume of sales. Its management had devised machinery capable of cutting manufacturing costs by two-thirds and, by reducing the price, aimed to popularize the game further and increase sales. It could not however, negotiate the necessary long-term loan to make and install the essential machinery.

Portland: Influence of Branch Banking.

The bank situation of Portland, Oreg., was found to differ markedly from that of Seattle. Two banks alone were reported to have more than 90 percent of all deposits in the State of Oregon. Both were banks having numerous branches, one having 42 in Oregon and 4 elsewhere, the other 23 in Oregon. One of these banks was itself a subsidiary of a larger banking group. A third bank was a branch of a San Francisco institution.

These banks had been built up through the purchase of small banks that were formerly independent. In the process, methods had been standardized and the old-time "personal banking," formerly prevailing, had vanished. This transition from "personal banking" to what was termed "mechanized banking" in Portland was commonly blamed for the credit and capital difficulties of small business, especially small manufacturing, which community leaders were actively trying to foster.

Instances were encountered in which banks that had formerly "trusted" small enterprises more on the basis of going-concern value and known integrity than on the basis of tangible security, had discontinued the credit accommodation upon which these enterprises had come to rely. Nevertheless, competition between the two principal banks was very active and had taken the form of competition for the small-loan business, including small loans to industry.

A service frequently rendered by the "personal banker," namely, that of making contact with private investment capital in behalf of local enterprise, ceased just at the time when small manufacturing was striving to become established. But an interesting case of a related activity was discovered. A banker had taken a personal interest in various promising young enterprises. This banker in his personal capacity had purchased equities in such enterprises; exerted an influence in training their management; stayed in long enough to see them established; and then had withdrawn his investment and gone on to other enterprises. Several of the younger entrepreneurs of the region were indebted to this capitalist for the success they had since attained.

These, however, were special instances, for development capital was still scarce and capital loans lacking, although the failure of finance companies, with the exception of one national branch, to gain a foothold was an indication that the short-term, working-capital situation was fairly satisfactory.

Substitute Forms of Financing.

Various substitutes for bank financing were observed throughout the region. Thus, a large central lumber corporation directly financed certain sawmills which supplied it with lumber, various lumber concerns financed small-unit logging operations of the "gypo" or tractor-driven seasonal type. These, and the financing of certain fish-canning operations by brokers who sold the canned product, were noted as examples of nonbank financing in which "big business" capitalized the small operation rather than integrating it directly or doing the seasonal work itself.

The fishing industry had developed a financing form of its own. The fishing fleets, excluded from bank credit, were financed by chandlers, who not only sold the fishing boats their supplies on credit, from food and gasoline to the boats and engines themselves, but also partly

handled their sales of fish when caught and furnished cash for their working needs. The activity of the chandlers closely resembled the factor, except that it was on a credit basis and actual responsibility was not assumed. The cost to the fishermen was apparently high; being largely hidden in price mark-ups, it could not be accurately determined. Many fishermen were in debt to the chandlers for all the fish they could catch; in turn, the chandlers themselves were badly extended, for the banks did not lend liberally to them as they did to the factors or finance companies in other cities, for relending purposes. The fishing industry in general was not regarded as a good banking risk, although it was one of the region's fundamental industries. This was not because of the physical risk involved, but rather the result of the luck factor in making the catch, and, more particularly, because of the poor organization prevailing in the industry.

Experience of a Community Fund.

The Portland Chamber of Commerce is primarily a small-manufacturers' association. In 1926, challenged by the need of capital for the development of manufacturing and local employment, it had adopted a plan of raising a local fund and had sponsored the organization of the Portland Industries Financing Service. The 21 directors of the organization included businessmen, community leaders, and some bank officials. About $200,000 was raised through the sale of stock. It operated largely outside the area of bankable risk, but charged 3 percent for its funds. Its policy regarding investigation and supervision of clients varied; in one case it virtually took over an indebted business, but usually general contact and a semiannual audit sufficed.

During the 14 years of its operation, this fund invested $425,655 in 28 concerns; paid dividends in 4 years; lost $40,331. Once launched, the fund was operated independently of the chamber of commerce; in 1938 it discontinued and at the time of the study was liquidating its holdings.

This venture demonstrated the community benefits which may result from making available relatively small amounts of capital to local concerns. It aided several new enterprises and, inasmuch as various enterprises grew, it helped create employment. On the other hand, undue risks were assumed in certain cases, and the fund was inadequate in relation to the community's requirements. It was this latter factor which led to the decision to liquidate.

SOUTHWEST AREA: HOUSTON, DALLAS, AND FORT WORTH, TEX.

This area was unique in comparison with other regions included in the field study. During the years when other sections of the United States were struggling upward from depression, Texas experienced a boom. It centered in the coastal plains of Texas, of which Houston, Dallas, and Fort Worth are the principal cities. It was thus possible to study the capital and credit difficulties experienced by small enterprises under conditions of prosperity.

Using available population figures, and the income estimates of the business publication, Sales Management, the per capita income in 1937 of Harris county, including Houston, was $788; of Dallas county, including Dallas, was $857; of Tarrant county, including Fort Worth, was $795. The national average was $540. Sales Management

estimated the effective buying income of Dallas county at $3,599 per family, and its volume of retail business at $160,615,000, the largest of any city in the Southwest.

Economic Basis of the Boom.

The economy of Texas is mainly a raw-material economy. The State is a large producer of oil, cotton, cattle, sulphur and other minerals. It also produces citrus fruits, vegetables, wheat and other agricultural products. Although the products of the State are varied, its relative prosperity has been based almost wholly on oil.

Nearly 40 percent of the Nation's oil output comes from Texas, and nearly 32 percent of the Texas oil production is from the 26,000 East Texas wells. Since the East Texas field was brought in in October 1930, it has produced 1,500,000,000 barrels of crude petroleum despite two temporary shut-downs and subsequent proration. Drilling, as well as production, has been active, 12,000 new wells being drilled in Texas in 1938, of which 9,600 were producers. Oil prices, at first driven down as low as 10 cents a barrel by the East Texas discovery, had recovered so that during 1938 an average price of $1.15 was obtained.

Oil has been a primary factor in the growth of Houston, which has 1,200 oil companies and 300 oil-well supply houses; these were said to occupy half the city's office space. A second factor is the Government constructed ship canal, making Houston a port. Shortly prior to the study this port had attained second place among American seaports, with gross annual freight of 23,000,000 tons. At Baytown, down the ship canal from Houston, is the Nation's largest assemblage of oil refineries. The depression in the cotton industry, Houston's former mainstay, would have worked havoc had not the oil boom occurred in time.

Dallas shares in the oil prosperity, although its industries are somewhat more diversified. Dallas is the headquarters of the Texas cotton industry, still the second industry in the State, which is the leading producer, with nearly double the Mississippi production. At peak, in 1923, the Texas cotton production was valued at $659,680,000. It declined to $189,739,000 in 1930, and to $129,688,000 in 1939. Acreage in 1924 was 17,049; in 1938, 9,153.

Dallas is also the most important wholesale and retail center in the Southwest, the fourth insurance center of the Nation, the State's leading banking center, and has the offices of 3,000 out-of-State corporations. It has a small garment and textile manufacturing "colony," but only a minor fraction of the cotton crop is processed here or elsewhere in Texas. Other manufacturing industries include automobile assembling, machine-shop products, cotton-gin and oil-well machinery, cement, furniture and fixtures, and saddlery. Dallas is also an educational and convention center.

Fort Worth is the largest cattle and grain market in the Southwest. The cattle industry, third in rank in Texas which has about 8,000,000 cattle, 9,000,000 sheep and 3,000,000 goats, accounted for $125,609,000 of production in 1938, compared to $66,376,000 in 1935, $185,778,000 in 1929, and $277,320,000 in 1920. Dairying and wool and mohair production are rapidly growing, as cattle declines. This city is also headquarters of the Texas wheat industry, which produced 35,046,000 bushels in 1938.

Need of New Manufacturing

Of the crude oil production in Texas, 80 percent is handled in Texas refineries. Texas flour mills handled 26,000,000 bushels of the 35,000,000 bushels of wheat produced. In other respects, processing in this area does not approach raw-material production. With 30 percent of the Nation's cotton production, Texas has less than 1 percent of the Nation's spindles. With large iron deposits in East Texas, and natural gas available for power, there is no iron or steel produced, though imported metal is processed to some extent. Meat packing is expanding, but is far behind cattle production. There is no wool or mohair processing industry. This defines the major economic problem of the area, which is that of progressing from a raw material to a processing economy before the oil prosperity declines.

There has been some progress along this line. There were 4,427 manufacturing units in Texas in 1937, according to the Census of Manufactures. This would indicate roughly 4,700 plants for 1938, since about 300 new manufacturing units are being started yearly. How many of the plants have less than $5,000 annual product value and, therefore, not included in the census, may be seen from the fact that the Directory of Texas Manufacturers lists 7,000 plants for 1938. The new and small ones are, however, mainly in food processing, woodworking, and printing. The needed economic development appears to center upon the growth of existing small plants and establishment of new ones to handle the raw production.

Abundance of Regional Savings.

As a result of years of oil prosperity, there is capital enough in eastern Texas to finance a large part of the transition to an industrial basis. The total resources of national banks in the State, which amounted to $969,500,000 in 1926, were $1,359,719,000 on September 28, 1938. To the latter figure, the State banks add more than $200,000,000 of resources, so that the total resources of all banks in Texas at the end of 1938 were $1,577,663,000. Total deposits were $1,377,168,000. Much of these regional savings are idle.

Stock and bond holdings by national banks were $115,510,000, and loans and discounts outstanding were $384,164,000.

Investment of Regional Savings.

There is no securities exchange in Texas. There has, however, been some local underwriting and sale of securities of local enterprises of the larger size, handled by investment banking and brokerage houses in Houston, Dallas, and Fort Worth. Among the security issues successfully floated locally in Dallas were—

Clay products concern	$450,000 1st mortgage 7 percent bonds, 1929.
Paper and box company	$250,000 1st mortgage 7 percent serial bonds, 1929.
State Fair Stadium (Cotton Bowl)	$300,000 6 percent sinking fund bonds, 1930.
Metal and boiler works	$250,000 common stock, and $250,000 6 percent serial notes, 1937.
Hosiery mill	$460,000 common stock, 1939.
Ice cream company	$75,000 common stock at $10 a share, 1939.
Department store	$255,000 7 percent preferred stock, 1937.

It appears that local capital has responded more readily to Texas enterprises which have had their securities floated regionally, by local underwriting houses, than to Texas concerns which had gone for their underwriting to national financial centers. In the case of one oil well

supply establishment, a New York underwriting not only brought unsatisfactory results in New York, but the issue was said to have met with less response from Texas investors than if it had been a Texas underwriting.

Not included in the above list is a certain number of underwritings of less than $100,000, of which there had been several. It was evident, however, that virtually all of the enterprises financed were of intermediate rather than small size; that the securities were those of established concerns; and that the total number of enterprises aided had met but a small fraction of the capital demand.

Direct private investment was found especially active in Houston, especially in the oil industry. It was found that some concerns manufacturing or dealing in oil field equipment were financed directly by individuals made wealthy by oil. Such individual capitalists have been, in part, non-Texan oil operators who came to Houston during the boom; others have been old Texas residents on whose landholdings oil was discovered. The inspiration of all such investments was an oil-equipment enterprise which began twenty-five years ago on less than $3,000 in borrowed money and is today a $15,000,000 corporation. On its way up, it interested a few wealthy oil men who, as individuals, provided substantial capital. Today its securities are nationally listed. In general, it was interesting to note that oil capitalists seemed eager to put speculative capital back into their own industry; and this was the outstanding instance of the investment of venture money in new enterprise which was found during the entire field study.

Some new manufacturing enterprises were privately financed by oil-enriched Texans. A case in point is the recent much-publicized launching of Southland Paper Mills, Inc., at Lufkin, first paper mill in the South to utilize the process of the late Dr. Charles H. Herty for manufacturing newsprint from Southern pine pulp. This $6,000,000 enterprise was financed through local subscription in excess of $2,000,000 and a $3,000,000 loan from the Reconstruction Finance Corporation. The investment was, in part at least, motivated by the desire of outstanding citizens to give Texas a new industry.

Much discussed, but still in the project stage at the time of the study, was a proposal to develop the east Texas iron-ore deposits by the use of natural gas as fuel. This project was being considered under chamber of commerce auspices, with the expectation that the capital would be locally and privately subscribed.

In 1939, a $2,000,000 corporation was organized in Dallas to make direct loans and to purchase securities, both bonds and stocks, of Southwestern industries. Its object was to supply expansion capital to companies whose needs are not met by short-term commercial loans and which did not seek R. F. C. loans. It was publicized as a "privately owned R. F. C." This company was organized under the auspices of an investment banking house. It had offered for public sale $1,000,000 of its securities. Its portfolio at the time of the study was said to be around $600,000; apparently its interests were largely in the hotel field but it also had interests in oil, ice, dairy, ice cream, and other companies. It was too early to judge to what extent this operation would expand and become a medium of contact between local capital and Texas manufacturing enterprise.

Limitations Upon Commercial Credits.

The situation as to bank credit in the east Texas area could be termed liberal as far as the attitude of the bankers was concerned. Nevertheless, restrictions of credit to small enterprises were found here as elsewhere. The limitations could only be ascribed to the institutional limitations of commercial banking in supplying small-business credits.

Thus, a Fort Worth bank in 1938 had loaned $24,500,000 to no less than 10,192 separate borrowers. Of these loans, 7,771, or 76 percent were less than $1,000 in amount, and 7,455, or 73 percent, were less than $500 in amount. This bank had considerably more than 40 percent of its deposits out in loans and discounts.

For the Dallas banks, the percentages of loans and discounts to deposits were generally between 25 and 30 percent. For example, one medium-sized bank with $23,300,000 in deposits had loans and discounts outstanding of $5,500,000. Of this amount, 17 percent was in oil loans. This bank was especially interested in what it termed small-business loans, mainly small-intermediate manufacturing. It also made business loans in participation with rural banks. This practice was followed by other Dallas banks. Little exception could be taken to the statement made by local bankers that any applicant capable of meeting banking standards could receive credit. The difficulty was such standards placed a considerable number of the smaller enterprises beyond the scope of bank aid either because they were not credit-worthy under existing commercial banking standards or else required credit for periods longer than seemed feasible to the banks.

In Houston, a bank with $52,000,000 deposits had $14,000,000 in loans and discounts outstanding. Another with $14,000,000 assets, however, had $8,000,000 in idle cash; and this bank was conducting a mail campaign to promote loans to manufacturers, jobbers and wholesalers on trade receivables at 8 percent. Its requirements of a 2 to 1 ratio for enterprises eligible for straight business loans was the prevailing banking requirement of the area.

Another Houston bank, out of 2,890 credit applications in the last 6 months of 1938 had granted some credit to 2,476. Another bank with $31,000,000 in deposits had $6,275,000 in loans and discounts outstanding.

Bank credits were generally extended for short periods. The practice of one Dallas bank, which had extended credits for 2- and even 3-year periods to intermediate-sized business establishments, was exceptional. The same discrepancy between banking time arrangements and the varying time requirements of business was found in this area as elsewhere.

Some Illustrative Cases.

A furniture store doing a million-dollar annual gross business in installment sales was able to obtain all the short-term credit it needed, but found it difficult to finance the installment collection period, frequently 2 years. Some relief was had by renewal of short-term loans at the bank, but this practice had limits. The growth of its city, with many families moving in and buying furniture, had depleted this company's reserves to the extent that it had ceased to expand its sales. Its management complained of losing the "new" business to a national chain

concern, solely because of inability to obtain the needed credit accomodations.

An oil and gasoline jobber and agent, who had started business on $10,000 capital and paid off $18,000 in 3-year notes taken by a parent oil company, now needed $5,000 to take advantage of trade discounts and make volume purchases. This loan was to be repaid at the rate of $1,000 a year. It was estimated that the saving made would more than carry this sum, as well as permit the employment of five additional people. This concern had formerly obtained as high as $9,000 local bank credit. It still owed $2,000. Plant and equipment were free and clear, but the needed long-term loan could not be had.

A small structural steel company, independent, fabricating reinforcement and structural products, and employing 65 men with an investment in fixed assets of $15,000, was renting its property and also much of its equipment. This company's major handicaps consisted of the great distances and high freight rates involved in serving points as far west as Arizona. It could overcome these handicaps by establishing a branch plant in another part of Texas if it could obtain $10,000, to be repaid in 5 to 10 years. But this sum could not be obtained.

A produce and general wholesaler, who had started business in 1934 by paying $180 for a bankrupt stock and now carried $15,000 inventory, stated that he was unable to discount more than 50 percent of his accounts receivable, although these were all from trade outlets.

A wholesaler of oil-well supplies, with approximately 80 accounts in 4 States, and net worth exceeding $150,000, was restricted because the trade practice in the oil fields called for selling terms of 2 percent 20 prox or net 60 days. Customers who wanted yet longer terms were continually encountered. The company was able to get abundant bank credit for 30 days, and at times as high as 90. Customer demands for long-term credit, however, frequently prevented the company from taking advantage of trade discounts on its own purchases. A $5,000 long-term loan, it was stated, would enable all discounts to be regularly taken and more than pay for the interest on the loan.

A small meat-packing proprietor, slaughtering about 50 hogs and 150 beef cattle weekly, had vainly sought a $5,000 intermediate-term loan. Although the markets, restaurants, hotels, and other packing houses to which he sold often paid cash, and never took longer than 7 days, he had to buy his animals on terms which did not allow more than 2 or 3 days' time. This brief lag had tied him up so that he now was in debt to the salt supplier. He asserted he could employ 5 more men and expand his sales 25 to 35 percent if only he could "unfreeze" that few days' lag.

CHAPTER XIX—APPENDIX 3

SPECIAL STUDIES

A MEDIUM-SIZED FINANCE COMPANY SPECIAL STUDIES

X company is a financing corporation, the stock of which is held by the members of a family, purchasing accounts receivable. It has an authorized capitalization of $1,000,000, with two classes of stock—$250,000 of 7 percent preference stock and $750,000 of common stock, par value $100 in both classes but never offered publicly for sale. X company's main office is in a large city; it has subsidiary offices in three States and agents in others. The three offices in the States other than that of its domicile are separately incorporated; these organizations are not empowered to enter into contracts but may only solicit business. All contracts are entered into at the principal office.

Business is obtained by newspaper and magazine advertising, direct mail solicitation, and from lawyers, accountants, bank employees, and bank officials. At times, commissions are paid to "finders" on the business they turn in. In the home State, solicitors are also directly employed.

This company finances small- and intermediate-sized business enterprises of every type. On a capitalization of $1,000,000, the yearly volume of business was $1,637,624. The company held $648,605 of clients' money on deposit, including reserves against slow accounts and uncollectibles. Earnings in 1937 were $20.65 per share of the common stock, and in 1938, $12.75; this was in addition to the 7 percent regularly paid on the preferred stock.

Against the $648,605 of clients' money on deposit, actual losses through uncollectibles less recoveries in 1938 were only $8,265.

While this company loans money on mortgage, it represents only 5 percent of its business. The remaining 95 percent is represented by the purchase of accounts receivable, notes, and trade acceptances, from a wide variety of trade and manufacturing concerns. While technically a purchase, each account is bought "with recourse," the contracts providing that the entire reserve held in the name of any given client may be applied to any receivable purchased from that client; interest is also figured on the sums advanced to clients at the time of purchase, and charged to the seller as long as the purchased commodity—i. e., the receivable—exists. However, since these transactions remain purchases despite these other features, as contrasted with loans on security of receivables, the legal regulations over lending concerns do not apply to the receivable operations of company X.

Funds for the purchasing of business paper are, first, the company's own available capital and reserves; second, funds raised by borrowing from commercial banks and other outside sources. The borrowing is undertaken in the following manner: The company deposits in a

bank, selected as trustee, all purchased receivables, notes, or trade acceptances, immediately upon purchase. The deposited paper is pooled, and its total value becomes the collateral against which the company issues 6-month notes, face value $100 or multiples of $100, bearing no interest until maturity. The notes are issued up to 80 percent of the face value of the trusteed deposits. After 6 months, 6 percent interest becomes payable; but in practice the notes are retired before maturity. These notes are sold at discounts of 1.5 to 2 percent, the purchasers including all major banks in the city of residence, a number of banks in the State of residence and in adjoining States, and one broker of commercial paper who, in turn, places the notes with banks or other investors. This broker regularly handles between $600,000 and $1,000,000 of X company's notes per year. The ratio of such borrowed money to the company's dealings was, on December 31, 1938, $1,105,000 in notes outstanding, to $1,637,324 in total value of receivables on deposit, or 67.5 percent; conversely stated, the company's own capital accounted for but 32.5 percent of its volume of receivables purchased and on deposit at that time. This ratio varies, the borrowed capital fluctuating with the volume of business handled.

In its dealings with business establishments, X company signs a separate contract with each client; the terms vary considerably. The contracts provide for a continuing relationship, under which each customer account arising from the client's credit sales is assigned to the finance company outright. The ultimate purchase price is the face value of each receivable less the fees and charges in each case. The cash payable upon acceptance is the latter amount, less the proportion withheld as the client's deposit; this proportion may vary with different clients, as may all other specific terms of the contracts. In practice, clients do not necessarily withdraw the entire sum initially payable; nearly $650,000 of moneys collected to the clients' credit remained in the possession of the company at end of 1938.

Collections from the customer are generally made by the client business concern, rather than by the finance company; the client countersigns the checks received and forwards them to the finance company. The customer may or may not know that his account has been assigned.

Losses have consistently amounted to less than 0.05 percent on the volume of business. Delinquencies have somewhat exceeded this percentage, but are compensated for by interest paid by the client business concern on past-due accounts, and by the repossession process. One lawsuit against a client was on record at the time of the study, but this is rare. Being a non-notification business, which is to say that the ultimate debtor is not apprised of the sale of his account to the finance company, it is to the client's interest to avoid the publicity of a suit. Protecting the finance company against loss are (*a*) the clients' deposits, applicable to uncollectibles as a reserve; (*b*) the customer's responsibility; (*c*) the possibility in certain cases of repossessing the purchased commodities.

Data were not available with respect to the actual cost of handling the average transaction, excepting that a partner stated that an account which did not return $75 a month was not profitable. A few client accounts ran below that amount of return. Individual receivables purchased ranged from $300 to $100,000 in face value, the average

being about $3,000. There were 333 active clients on January 1, 1939; 496 on June 7; 410 on June 29; since the demand is for working capital only, and such demand is often seasonal, the number varies.

Individual contracts with clients varied according to the type of business, its location, the credit terms allowed by it to its customers, the average value of the receivable, the credit standing of the client business and of its customers, and, in the last analysis, what the traffic would bear. Types of charge included interest on the initial payment, although technically a payment on account of purchase, a service charge, an interest charge payable by the client after the delinquency date on each receivable, and, in certain cases, a flat or annual fee, said to be a holdover from the indemnity bond fee, though such bond was no longer required.

Two major types of contract were offered, a daily rate plan and a more complicated annual rate arrangement. Under either plan, to estimate in advance what the money actually costs the client would be difficult, and most clients only learn the average annual cost of the financing through experience.

Under the daily-rate plan, the client pays interest on the face value of each receivable for each day it remains to any extent unpaid, interest being figured daily; the interest rate ranging from one-sixtieth of 1 percent to one twenty-fourth of 1 percent a day. There is no added delinquency interest charge. This is combined at times with a flat annual charge, though not with a service charge. The initial sums payable to the client vary from 60 to 80 percent of the account receivable. Ten cases under this contract, selected at random, follow:

Company	Face value of receivables	Initial cash payment	Interest daily on face value	Added annual charge
		Percent		
Picture Frame Co	$2,500	75	1/30 of 1 percent	
Calendar Co	6,000	60	do	$250
Tool Co	5,000	80	1/32 of 1 percent	
Steel & Brass Co	4,000	75	1/30 of 1 percent	150
Lumber Co	1,000	75	1/24 of 1 percent	
Rubber Co	1,000	80	1/40 of 1 percent	
School Supply Co	1,100	75	1/60 of 1 percent	
Overall Co	2,500	80	1/40 of 1 percent	
Granite Co	600	65	1/25 of 1 percent	
Novelty Furniture Co	80,000	80	1/30 of 1 percent	

Under the more complicated annual-rate contract, interest at 6 percent is charged on the amounts of cash released to the client. The interest runs undiminished until full retirement of the given account receivable, even though such retirement is usually gradual. A delinquency date is specified as to each receivable, and there is an added interest charge, usually one-fifteenth of 1 percent a day on the unpaid balance, after that. There is also a service charge, figured at 0.5 to 2.25 percent on the face of each receivable. An additional flat annual charge is more frequent with this type of transaction. Sixteen cases under this contract, selected at random, follow:

262652—41—No. 17——24

Company	Face value of receiv-ables	Initial cash payment	Interest on initial payment	Service charge against face	Delin-quency period	Interest daily on delin-quent amount	Added annual charge
		Percent	*Percent*	*Percent*	*Days*	*Percent*	
Coal Co	$4,300	75	6	0.5	35	1/15	$50
Waste Co	600	75	6	.75	45	1/15	60
Rubber Prod. Co	1,000	75	6	.625	30	1/15	100
Metal Prod. Co	350	75	6	.75	90	1/30	
Casket Co	400	80	6	1.00	90	1/15	
Pipe Co	5,600	75	6	1.00	60	1/15	
Casket Co	1,500	60	6	2.25	90	1/15	100
Paper Co	550	75	6	{ .25 .6	17 90 }	1/15	
Furniture Co	600	75	6	2.00	60	1/15	60
Artificial Flower Co	1,000	70	6	1.25	60	1/15	100
Glass Co	600	75	6	.75	60	1/15	100
Drug Co	1,375	70	6	.8	45	1/15	100
Millinery Co	600	75	6	.75	45	1/15	100
Garment Co	1,000	75	6	1.00	90	1/15	
Hat Co	300	60	6	1.5	90	1/15	
Trailer Pts. Co	300	70	6	1.5	30	1/15	25

It is not to be understood that this company's acceptance of clients or of their receivables is done without regard to risk; on the contrary, this firm's accounts are selected with the greatest of care and business acumen. This fact has a bearing upon the rates charged. An analysis of specific cases as set forth in the foregoing tables discloses that, for one transaction in financing a receivable until its retirement, the charges may amount to as high as 3 or 4 percent of its face value, or even higher. In the event of delay in retirement of the account, the charges are further increased considerably. Therefore, if the client's collection cycle turns over from six to nine times a year, which is not unusual, the cost of securing working capital on a continuing basis may be onerous, especially to the small concern. On the other hand, with money coming to the corporation at the aforementioned rates on a rapid turn-over, and with losses negligible, it is evident that the margin of profit is considerable in relation to the risk involved. The transactions in receivables being purchases and not, in the legal sense, loans, competition among finance companies must be relied upon to control the rates that are charged for this type of financial accommodation.

A FINANCE COMPANY OF MAJOR SIZE

This finance company is of national scope and operates more than 300 offices throughout the United States. In addition to the parent company there are 38 subsidiaries. The volume of business done by this organization and its growth in recent years (due in large part to acquisitions and consolidations) may be seen in the following year-by-year record of the consolidated net volume of accounts acquired:

1924	$95,509,475	1932	$317,397,520
1925	148,015,075	1933	475,884,330
1926	206,113,930	1934	779,749,248
1927	188,271,263	1935	765,724,853
1928	282,163,895	1936	1,169,696,815
1929	489,544,018	1937	1,291,704,138
1930	392,044,170	1938	696,460,770
1931	374,093,766	1939	966,383,708

The retail and wholesale automobile financing by this concern was about 61½ percent of its total volume of business in 1939. The re-

maining 38½ percent involved only receivables based on durable or semidurable (repossessible) commodities, such as refrigerators, furniture, machinery, etc., and trade accounts of manufactures financed by factoring subsidiaries. This company accordingly performs an important role in financing the sales of the large industrial establishments producing those types of commodity that are normally sold on the installment plan. In some instances the same merchandise figured twice, this company first buying the dealer's debt to the manufacturer, and later the purchaser's debt to the retailer. At the end of 1939 the company was carrying 1,190,282 separate receivables, averaging $238 in value. The average monthly collection was $23.86 per item, indicating the prevailing term of the transactions as considerably longer than in the case of the preceding study, due to the prevalence of installment-sale transactions.

In the case of so large a concern, with so many subsidiaries, it is not possible to recount the many varieties of transactions entered into with client business concerns and the types and variations of charges exacted. The major features of these transactions, however, are the purchase of selected accounts "with recourse"; the retention of reserves; and other practices mentioned as characteristic of this unregulated "intermediary banking" field.

Over a 10-year period, including the depression, a net profit of 1.7 percent on the total volume of transactions resulted in average annual earnings for the decade of $11,875,315. At the end of 1939 the invested capital was $63,779,026. In addition there was earned surplus of $23,979,726, and paid-in surplus of $28,759,019.

This concern has been a major bank borrower. On December 31, 1939, the total receivables on hand were $362,108,426. Bank loans were $188,440,980, or 52 percent of receivables held.

At the end of 1937, the peak year of operation, the total receivables held were $466,275,313, and bank loans were $288,751,375, or 61.9 percent of the value of receivables. This enterprise keeps its own capital fully employed, and borrowings from commercial banks constitute the fluctuating factor in its operations. The volume of bank loans changes constantly as the volume of business in receivables rises or falls. Bank borrowings have run as high as $300,000,000 at one time. More than 300 banks supply funds to this concern and its subsidiaries. On its borrowings from banks this concern pays regularly at the rate of 1.75 percent annual interest. The company has also issued debentures. This alternative method of raising money acts as a competitive check on the interest rate charged by the banks. At the end of 1939, $8,000,000 of 3-percent debentures was outstanding. Additional debentures previously outstanding, some of which had carried 3½ percent coupons, had been redeemed by the use of proceeds of bank loans, and that item of earlier debt was represented in the consolidated balance sheet as of December 31, 1939, by $52,500,000 of 1¾-percent notes due banks in 1943–45.

The loss ratio has been very low. At the end of 1939 unliquidated repossessed automobiles on hand amounted to one-eighth of 1 percent of retail automobile accounts on the books; and installments 30 days or more in arrears were 0.31 percent of total installment receivables. Even this ratio of 0.435-percent arrearages was protected, since clients are obligated to make good all receivables which they assign to the company.

Factoring became a branch of this company's financing activity in 1928. The first year of its business in this field totaled about $38,000,000 and expanded to almost $300,000,000 in 1937. In taking over factoring enterprises the company injected only its executive supervision, leaving existing managements in actual control of operations. The three factoring subsidiaries, it is claimed, compete with one another rather than operating in concert.

In addition to the major fields of financing in which this company operates, there has been a substantial development in the installment financing of industrial purchases of heavy machinery and equipment. This service has worked out as an aid to the small business which, because of a difficult current position, would otherwise have been unable to install needed equipment.

While most of the clients of this company are small business concerns—having, with a few exceptions, annual volumes of less than $200,000—they are prevailingly those small concerns which deal in the durable types of commodity, and the emphasis of the financing service rendered is upon these commodities. Thus, the small enterprises financed are either specialists in handling commodities of the particular types, or, if more general in their scope, are likely to be financed only in respect to their durable-goods sale. This preference as to the type of commodity aided in its movement to market, as well as typical details of representative cases and of the terms and charges involved, may be seen from the following table:

Cases of small client concerns that have discounted receivables, with recourse in 1939

Type of business	Amount of installment receivables purchased in 1939	Percent of face value advanced	Service charge	Interest rate	Term or period arranged	Other charges or costs
		Percent	*Percent*	*Percent*	*Months*	
Restaurant equipment	$55,000	80	12.00	----------	36	None.
Furniture store	983,000	57	----------	7	12	Do.
Store fixtures	176,000	57	----------	6	12	Do.
Furniture store	350,000	50	----------	9	12	Do.
Appliances	160,000	66	4.65	----------	12	Do.
Furniture store	50,000	50	4.60	----------	12	Do.
Store equipment	105,000	50	2.50	6	18	Do.
Kitchen equipment	750,000	60	----------	8	12	Do.
Furniture store	400,000	56	----------	9	12	Do.
Pumping equipment	1,000	100	13.01	----------	36	Do.
Tractor	3,000	100	1.35	6	15	Do.
Display fixtures	2,000	100	9.15	----------	24	Do.
Trailer	2,000	90	5.85	----------	17	Do.
Bakery machinery	8,000	90	1.00	6	18	Do.
Service vehicles	2,000	100	7.70	----------	24	Do.
Diesel engine	7,000	80	1.00	6	40	Do.
Dental equipment	2,000	90	9.40	----------	36	0.30 percent for insurance.
Do	3,000	100	10.50	----------	36	Do.
Construction equipment	5,000	100	1.00	6	12	None.
Bakery ovens	2,000	90	2.00	6	36	Do.
Railroad equipment	110,000	100	9.25	----------	36	Do.
Diesel engine	5,000	100	.75	6	18	Do.
Road machinery	9,000	90	.50	6	12	Do.

The variation in interest rates in the above is explained by the fact that the paper already has been made before it is acquired by this company. Service charge is determined in relation to such interest rate, with weight given to the period of repayment that applies in each case. In all instances the interest rate is on an annual basis. Service charge and interest apply only to the amount of money actually advanced. The relatively high service charge is made when the paper acquired carries no provisions for interest payment. Service charge is deducted in advance.

Repayment in all above cases is on a monthly installment basis.

An important subdivision of the company's activity consists of the financing of purchases of machinery and equipment by business concerns. The periods of payment vary considerably, as also do the service charges, as may be seen from the following table:

Financing in 1939 for small business concerns of purchases of machinery or equipment

Type of business	Amount involved	Service charge add-ons, percent	Interest rate, percent	Term or period arranged, months	Other charges or costs
Tug	$45,000	1.50	6	36	Survey, documentation, $250.
Packaging machinery	1,000	----------	6	12	None.
Screw machine	1,000	2.00	4	12	Do.
Machine tools	12,000	1.50	6	36	Do.
Arc welding machinery	8,000	50	6	24	Do.
Woodworking machinery	3,000	----------	6	10	Do.
Oil barge	44,000	1.50	6	36	Documentation, $61.60.
Roasting machine	4,000	.50	6	24	None.
Diesel engine	3,000	.50	6	13	Do.
Machine tools	3,000	.50	6	16	Do.
Printing press	76,000	4.85	4	38	Do.
Deep-well pumps	8,000	1.50	6	36	Do.
Foundry equipment	9,000	1.50	6	36	Do.

Repayment in all above cases is on a monthly installment basis.

In its financing of the sales of automobiles at wholesale, the charges are virtually uniform, irrespective of the size of the client enterprise. The interest rate is uniformly 4 percent on an annual basis, and the period allowed for payment is uniformly 3 months; the service charge is uniformly $1 per car, made to offset insurance cost. These advances are not subject to installment payments; at the end of the 3-month period, a portion may be paid and the remainder renewed at the same rate.

AN INVESTMENT COMPANY AND INTERMEDIATE-SIZE BUSINESS

Y Corporation, an investment company or trust of the broad general management type, was organized in 1929 for the purpose of rendering an investment and lending service to business, in the zone of finance lying between the activities of commercial banking, and those of investment banking. It subsequently merged with two similar companies.

The scope of its activities were described as follows:

> Somewhere between bank credit and research development by strong corporations on the one hand, and the somewhat haphazard risk taken by private capital on the other, is a field of economic usefulness in finance. The lines may cross to some extent, the field may be broader today because of the apparent timidity of private capital, but there has always been a place in our economy for an organization devoted to careful study of such opportunities, with a fund of capital at its disposal. Certainly, extreme risks should be avoided, but properly administered, such a fund will in time permit the average small investor to participate in undertakings heretofore almost entirely closed to him.

Specifically, the activities of Y corporation were to include—

1. Financing the expansion of growing business undertakings unable, or unwilling, to obtain capital through public offering.

2. Working-capital loans.
3. Financing new enterprises.
4. Reorganizations and liquidations.
5. Seasoning of securities prior to public offering.
6. Underwritings.

Activities in these directions from 1929 to 1935, while limited because of economic conditions, included certain equity investments classified by the corporation as "special situations." By the end of 1935, the corporation had entered into 16 "special situations" the maximum investment being approximately $53,365,000, with most of the individual participations being in excess of $1,000,000. The bulk of the activities of the company were devoted to the customary lines, *i. e.*, the purchase and sale of standard listed securities.

In 1936, its president announced that the company was prepared to enter into new special situations. As the result, applications flowed in from business enterprises in need of financing. While not specialists in appraisal, the corporation's permanent personnel includes men with both business and financial experience. Outside independent experts were employed to supplement the preliminary findings of the company's permanent staff. Some indication of the needs of business for financing, as reflected in the Y corporation's records may be seen from the following table which shows the number of applications received, the amount of capital requested, and the assets of the applicant companies:

Capital requested

Size of request	Number of applications			
	1937	1938	1939	3-year total
$10,000 to $100,000	29	117	38	184
$100,000 to $200,000	10	42	48	100
$200,000 to $500,000	13	43	37	93
$500,000 to $1,000,000	13	26	36	75
$1,000,000 and over	11	41	47	99
Total applications	76	269	206	551

More than 50 types of business were represented, including machinery, automobile parts, tires, building and related lines, iron and steel, food products, pulp and paper, oil and related industries, utilities, fisheries, and financial concerns. The size of the applicant companies, in total assets, was as follows:

Total assets of companies

Assets	Number of applications			
	1937	1938	1939	3-year total
$10,000 to $100,000	14	105	27	146
$100,000 to $500,000	21	44	69	134
$500,000 to $1,000,000	17	55	31	103
$1,000,000 and over	24	65	79	168
3-year total	76	269	206	551

Out of 551 applications, 14 were approved for investment.

The total number of special situations entered into since 1929 was thus 30. However, as 10 of these 30 situations had been liquidated by the close of 1939, the company is now interested in 20 situations.

The 14 applications approved for investment since 1935 included equity and credit investments. Increases were also made in 5 companies in which investments had previously been made. In the case of 6 companies in which investments had been made, 4 were organized by Y corporation.

The total amount invested directly in business enterprises by Y corporation during the period 1936–39 was $2,234,860. The assets of the companies in which the investments were made ranged from $687,000 to $1,500,000. Y corporation, during this same period, has also made indirect investments in the amount of $8,647,806. The assets of the companies in which such indirect investments were made ranged from $570,000 to $586,000,000.

The limited number of undertakings resulted from a highly selective policy, arising from the fact that the company regarded its financial activity as a "pioneering effort" and was, as a spokesman of the company put it, "in the creeping stage."

The criteria governing the investment decisions were—

1. The business of the applicant must be profitable and an expanding industry.

2. The business of the applicant must have sufficient security for the invested capital.

3. The management must be satisfactory.

4. There must be a sufficiently large position in the equity to make the investment whorth while, and, in some instances, to enable the exercise of a voice in the management.

5. The applicant must show a sufficient prospect for the retirement of the investment at a profit within a minimum of 5 years.

The reasons for the rejection of applications as stated by the president of Y corporation were—

A. *Unsatisfactory type of business.*—This may mean either that we feel that the industry in which the company is operating has little future or that the company itself has no possibility for growth. We naturally have a great many requests to supply capital to finance inventions. We do not do so, first, because in practically all instances, of the extreme hazard; and, second, because it is very seldom that an invention is commercially practical at the time the inventor sets out to obtain capital. Our experience in the direction of a number of corporations is that frequently in the course of the business of those corporations sound inventions are developed by the technical staff, but it always takes a number of years of development before commercial feasibility is reached.

B. *Too small an investment.*—This is not an absolute figure but depends to some extent upon the growth possibility of the company. Of course, it is conceivable that a small company might grow rapidly and that an initial investment would be preliminary to a subsequent larger investment. We also have the practical difficulty of attempting to service a large number of very small investments. We have given some thought to ultimately setting aside a moderate amount of capital in a separate organization to sample the field of small-capital requirements. The great difficulty is that frequently a small business is built around a dynamic individual and with the disappearance of that individual the business likewise disappears. Such instances obviously are not suitable for institutional investments.

C. *Unsatisfactory management.*—Our primary requisite is that a company in which we make an investment has good management or had good management available to it. In some cases we have been approached by existing managements who have done what we feel to be an unsatisfactory job and without eliminating them we would have no confidence in the future of the company. It frequently happens that the approach to us for capital is on the part of managements who

have not evidenced satisfactory capacity, in fact, the necessity for capital is often due to this cause. Again, such a background, unless a change in management is contemplated, does not warrant an investment.

D. *Promotional.*—A number of cases have been brought to us by individuals who have merely an idea with no operating experience, no equipment, and no funds. It is very rarely that such beginnings develop into investments.

E. *Too high price.*—This again is not an absolute measure but is based upon our evaluation of what a particular situation may be worth. It is not unusual for our ideas of value to be considerably below those of the present owner. In making an investment in an unliquid situation we feel that there must be compensating profit possibilities commensurate with the risk involved in the time required for seasoning and maturity. This consideration also enters into our determination of price.

A comparison between the special situations and the standard portfolio is set forth below:

	Special situations		Standard portfolio	
	Average investment	Yield, percent	Average investment	Yield, percent
1936:				
A [1]	$2,288,933	7.41	$24,754,692	6.69
B [2]	2,757,858	6.15	41,071,902	4.03
1937:				
A	3,744,379	12.40	25,975,885	6.40
B	4,611,015	10.07	36,621,692	4.54
1938:				
A	5,241,300	5.89	21,035,932	3.65
B	5,404,350	5.71	19,174,833	4.00
1939:				
A	6,388,791	4.91	21,894,819	4.31
B	6,173,310	5.08	21,460,498	4.39

[1] Ledger value.
[2] Market value.

AN EXPERIMENT IN VENTURE FINANCING

Speculative business ventures by a group of Chicago businessmen who, although operating as individuals, but with the aid of an investigatory organization established for that purpose, provides an interesting example in venture financing for small-business enterprises.

The investments made by this group were largely in untried business. No investments were made in rescue situations nor were businesses in distress, or with frozen current positions considered: The investments were of a venture nature with the result that the record reveals both dismal failures and phenomenal successes. It is interesting to note, however, that on balance the group made money.

In every case the capital that was invested or advanced was in enterprises which banks or other financial institutions would reject. Many of the enterprises financed by this group were at the outset nothing more than an invention or an engineer's idea.

In the selection of enterprises, highly competitive fields were avoided. The group was more interested in launching or supporting a business that would create new products or develop new markets.

The activity of the group had its inception in 1919, when executives of a nationally known accounting firm observed that some of their clients could use additional capital profitably. One of the executives of the accounting firm and a few of his associates, all of whom had surplus funds for investment, determined to organize their investment activities.

After they had participated in a few situations, they placed their activities upon an organized basis by forming a nucleus corporation.

Into this corporation, 25 individuals put $25,000. The business of this nucleus corporation was to investigate and report on situations calling for venture capital.

The investigatory work was in the hands of an executive committee of five members, who reported to the stockholders on each situation. Each individual stockholder thereafter determined whether or not he would participate in the situation. No stockholder was required to participate, but participations were made subject to full subscription of the amount of money required. Frequently two or three stockholders made up the full amount required.

The following rule was observed in the operation of this nucleus corporation: "No stockholder's funds shall be called upon for investment, or invested, except upon his own subscription, nor will any funds of the company be used for investment purposes." The corporation was not expected to earn more than operating expenses, funds to accrue from fees for financing or from bonus stocks received as compensation for arranged financing.

While an effort was made to explore thoroughly the situations presented, a considerable amount of speculative forecasting and plain guesswork was involved. The integrity of a management was given considerable weight and, as explained by those identified with the activity, the investment involved gambling on existing management rather than putting in a new management. Members of this investing group, however, invariably had representation on directorates and exercised supervision over the budgets of the enterprises in which investments were made.

While not all situations were handled alike, it was the general practice to take preferred stock in an amount equivalent to the investment, and to receive a substantial equity interest as a bonus.

At the beginning, the group found its financing opportunities through their own business contacts. Later, as the business of the group grew and became known, opportunities presented themselves through banks, investment bankers, advertising agents, lawyers and public accountants.

The nucleus corporation was liquidated in 1930 with a total loss of capital. However, the investments made by the stockholders as individuals carried over. Despite the loss of capital of the nucleus corporation, the experience of the group was such that a second nucleus corporation was set up early in 1939

The members of this group have made investments in 23 small business enterprises (most of them new) of $1,972,276. Not all of the investments were profitable. In some cases, there were complete losses.

A distinctive feature of the financing methods of this group was the provision of adequate credit sources for the enterprises. As a rule, the initial financing provided only scant working capital, and in most cases the venture would have collapsed had it not been that the group stood ready to make loans or to guarantee credit to the venture.

The results with respect to the 21 projects in which investments were made are as follows: Total capital in the amount of $1,937,276 was made available; dividends were received by the group in the amount of $314,414; capital repayments were received in the amount of $2,507,311; the book value of the equity held at the close of 1939 by group members was $1,636,867. The group members who invested

or loaned $1,972,276 in 23 enterprises have received cash dividends of $314,414; have received in repayments and redemptions $2,507,311, or $570,035 more than the $1,972,276 made available; and still hold securities having a book value of $1,636,867.

During the period 1927–30, when the first nucleus corporation was operating, members of the group made capital available for 10 projects. To measure results, a share of $1,000 investment in the capital of the nucleus corporation would have entitled that member to a one-twenty-fifth participation in each of the projects. Assuming full participation in each instance, the results worked out as follows: The average member would have invested or otherwise made available $22,507 for the 10 projects and, adding his $1,000 investment in the research corporation, his total outlay was $23,507; he lost the $1,000 in the nucleus corporation and also lost $4,000 in one of the projects; he received from redemptions and repayments $12,180, leaving his remaining investment $11,327; he received in dividends and interest $7,918, leaving the net amount of cash not returned to him $3,409; he still has equity in various of the projects with a present book value of $13,701; to date, the net gain for him in dividends, interest, and equity totals $10,292.

Another measure of the success of the venture may be found in the summary of a project set in motion in 1933: In this instance, members of the group made available $25,000 in loans, receiving equity shares as a bonus. This business now employs in its factory about 250 men, has more than 1,000 individuals in its national sales organization, and has 70 employees in its home office. The company began as a sales corporation, but now has a wholly owned manufacturing subsidiary and a wholly owned installment finance company.

Aggregate statistics for 12 of the 23 enterprises still operating are: Total assets, $4,889,998; total net worth $2,792,327; annual volume, $5,971,516; net income, $397,026.

A summary history of each of the projects in which this group participated from 1919 to date follows:

A. *A small installment finance company operated by a partnership.*—Its annual business amounted to about $300,000. Because it was decided that additional capital would permit expansion, $25,000 was invested and a corporation was formed. The new capital was equivalent to 16.3 percent of the resultant total assets and 38.5 percent of the resultant net worth. In exchange for the new capital the investors received 38.5 percent equity in the corporation. The business grew to an annual volume of more than $800,000, producing an annual net income in excess of $35,000. The business was sold to one of the major installment financing companies after dividends paid on the new capital had amounted to $84,736. The company had invested in one of its client companies (B below) and the stock so acquired was distributed among the stockholders.

B. *A small partnership engaged in the retail sale of aluminum household utensils.*—A corporation was formed (with the aid of A above); the initial investment amounted to $8,000, to which was added a loan of $8,000. The group subsequently loaned the corporation an additional $50,000. The interest of the group was represented by $50,000 preferred stock and $16,000 common stock, the latter being 32 percent of the equity. The partnership had done an annual business of about $48,000. The business grew to such an extent that within a few years

sales reached a peak of $5,112,720 and produced a net income of $800,357. Assets grew from $10,000 to $1,821,089 and a deficit in working capital was transformed into a net working capital of $1,048,442. The equity interest of the group was disposed of for approximately $1,920,000. The loans were repaid in full and the group had received $32,000 in dividends.

C. *An individual perfected patents pertaining to oil burners, but was without capital.*—A corporation was formed, succeeded by a limited partnership. The group invested $35,416 to provide working capital, which figured as 37½ percent of total assets, receiving a proportionate share of the equity. The group also made available $50,000 in the form of a loan. The company did not engage in manufacturing, but derived its income from royalties and from the sale of devices manufactured to specification by others. At its peak the company's gross annual profits were $127,616, and net income $42,821. From 1927 to 1939 this company perfected 31 patents. These had a book value of $205,395, of which $65,942 has been amortized. All of the loans have been repaid. The group has received dividends of $29,250. The book value of the present equity is $71,880.

D. *A corporation manufacturing furnaces.*—Members of the group became interested in this company because it was thought it would provide a good medium for some of the patents of the company described in C, above. A new corporation was formed to acquire the assets of the predecessor business. Members of the group invested $50,000 and loaned the company $153,000 receiving its convertible notes. Business volume grew from $523,417 to $918,060, with a peak profit of $97,263. Thereafter, the company's business declined drastically; it was forced to cut prices; and took large inventory losses. The business was reorganized. The original $50,000 capital investment by the group was lost. For the $153,000 of convertible notes in the old corporation they received $60,435 in new securities. The group holds a 25-percent equity in the new corporation on which dividends of $20,250 have been paid. The present book value of the equity is $19,250.

E. *The development and manufacture of a radio set invented by an electrical engineer.*—In this situation members of the group invested $25,000 for which they received $25,000 in preferred stock and 50 percent of the common stock. The business was not successful and the investment was a complete loss. However, further inventions by the inventor led to subsequent ventures, one of which was a phenomenal success.

F. *This company was formed to bring together the inventor just referred to with another inventor.*—Members of the group advanced capital of $16,756 to permit promotion and development of various electrical inventions by these two individuals. Of the amount advanced, $15,000 was repaid the following year from royalties. From the same source the company accumulated sufficient funds with which to launch a new company (G below) for the manufacture of electrical clocks. Company F was subsequently liquidated and the stock in company G (described below) was distributed to its stockholders.

G. *G company commenced business with a capital of $25,000 all of which was provided by company F.*—For the money advanced company F received $25,000 of preferred stock and 500 shares of common stock, which represented 50 percent of the common stock issued. Subse-

quently, the members of the group purchased additional common stock in the amount of $125,000. They then held 12,500 shares, or 62½ percent of the common stock outstanding (this in addition to the $25,000 of preferred stock). Subsequently, the group added $156,250 to their investment, their proportionate equity remaining the same. To the manufacture of electrical clocks G company later added the production of electric organs. The company now has $1,742,000 in total assets, a net working capital of $735,777 and a net worth of $1,435,178. Its peak gross profit was $908,879, and its peak net income, $170,988. On its participation, the group has received dividends of $312,500 in preferred stock. The preferred stock representing the original investment of $25,000 has been redeemed. The present book value of the equity is $568,000. The market value of the preferred and common stock held by the group is now approximately $1,012,500.

H. *Company H was formed to manufacture a device developed by company E above.*—Members of the group invested $25,000 and received $25,000 in preferred stock and 50 percent of the common stock. Although the device did not prove practical, the preferred stock was redeemed in full before the corporation was liquidated.

I. *Company I was organized to take over the pole-treating department of a pole company, the manager of which became the head of the new company.*—For its investment of $50,000, which amounted to 86 percent of total assets of the corporation, the group received $50,000 of preferred stock and 50 percent of the common stock, holding an additional 10 percent of common subject to the manager's option to buy after redemption of the preferred stock. The business grew to a peak volume of $227,880, with a net income of $32,002. It is still operating with moderate success. The investors have received more than $12,000 in dividends on their preferred stock, $40,000 of which has been redeemed. Through endorsing bank loans to the corporation which they later were called upon to make good, the group members have added to their equity so that now they own seven-twelfths of the common stock represented by a present book value of about $35,000. The loans which were taken over by the group have been repaid by the corporation. The corporation's earned surplus was $38,000 at the close of 1939.

J. *A small tool manufacturing corporation.*—Members of the group invested $25,000 for which they received $25,000 of preferred stock and 50 percent of the common stock, but because of disagreement with the management the entire interest was sold back within a few months at cost.

K. *A corporation engaged in manufacturing building blocks of cinder and concrete composition.*—Operated by a trustee on limited capital, the company was confronted by receivership. With building active, it was thought that with adequate capital the company could expand its operations to a profitable level. Members of the group formed a corporation for the purpose of taking over the business. They invested $150,000 and advanced $40,000 to the company, the group receiving for its investment $150,000 of preferred stock and 70 percent of the common stock. Although the business prospered for a short period, it was speedily hit by the slump in the building industry. Assets of the company were sold at foreclosure and the investors recovered only $10,000 of the $40,000 loans, the $150,000 in investment being a complete loss.

L. *A corporation for the manufacture of X-ray supplies.*—Members of the group invested $100,000 to buy the business of a partnership. A corporation was formed, the interest of the group being represented by $50,000 of preferred stock and 8,600 shares, or 95.5 percent, of the common stock. The depression caused a setback in the business of the corporation from a peak volume of $361,484, and a net income of $29,260 to a volume of $147,932 and a net income of $2,806. Dividends of $16,000 have been paid and the present book value of the group's proportionate equity is $70,341.

M. *A concern manufacturing china and hotel equipment.*—Members of the group made advances aggregating $95,000. The enterprise did not show promise and the project was abandoned. Members of the group recovered the amount advanced.

N. *A corporation to manufacture a heating plant draft regulator.*—The device was invented by an engineer who had no funds with which to put his device into production. The group invested $25,000, receiving $25,000 in preferred stock and 450 shares, or 60 percent, of the common stock, in exchange. The enterprise did not prosper and after one-half of the preferred stock had been redeemed, the business was sold to company D. For the preferred still outstanding, the group received notes, and in the subsequent liquidation of company D received $4,906 for $12,500 face value of notes.

O. *A new company set up to manufacture an automobile steering-wheel lock.*—An investment of $5,000 was made in company O for which the group received $5,000 in preferred stock and 500 shares, or 25 percent, of the common stock of the new company. The venture was not successful. The business was liquidated with a complete loss of the investment.

P. *Two small X-ray manufacturing companies were merged to form company P.*—An investment of $405,000 was required of which members of the group provided $139,890, or 34.5 percent. The company was not very successful. It was sold soon after formation to Westinghouse for the amount of the investment, plus interest.

Q. *Company Q began as a small manufacturing enterprise producing an agricultural insecticide.*—Members of the group invested $2,500, receiving a one-third interest in the partnership. In the first 4 months of operation the company did a business of more than $42,000 and made a net income of $17,937. Recognizing the potential profits available, the initial partnership was dissolved and a new partnership set up. For their $2,500 the group received $8,500 in the liquidation. The group invested $125,000 in the new partnership, receiving a 50 percent interest in the new venture. Subsequently the business was incorporated, the group receiving $100,000 in preferred stock, $25,000 in notes, and 1,000 shares, or 33⅓ percent, of the common stock for their interest. The business attained a volume of $122,933 in the first year of its operation as a corporation. The company had over-expanded its business and it ended the year with a net loss of $15,600. The company has, however, carried on considerable research and its prospects are regarded favorably by the group. It is expected that a new line of products will produce a 1940 volume of $300,000.

R. *A corporation manufacturing phonograph needles.*—The group invested $15,000. For its investment the group received $15,000 of preferred stock and 600 shares, or 49 percent, of the common stock. Within 7 years the company achieved a peak sales volume of $274,128,

and a net income of $121,720. The most recent annual statement reported a volume of $204,185, and net income of $59,860. Assets now amount to $194,121. The corporation has paid a stock dividend of 16 shares of new common on each share of old common outstanding so that the group now holds 10,200 shares of common (49 percent of the equity). The 10,200 shares have a book value of $75,555. The preferred has been retired. The group has received $120,150 in cash dividends on their common stock.

S. *An aviation company whose operations included sight-seeing tours and an air port.*—The group provided $64,250. They received for their investment 6,425 shares of A stock and 12,850 shares, or 15.73 percent, of the common stock of the company. The company's operations were not successful. It was liquidated, the group receiving $2,088 of the $64,250 put into the enterprise.

T. *A company selling household metal ware.*—An investment of $25,000 was made, for which the group received 2,113 shares, or 10.5 percent, of the common stock of the company. The business grew rapidly and the corporation accumulated sufficient resources to build its own plant. The business reached a peak volume of sales of $3,280,103, and a net income of $308,897. The most recent annual statement shows assets of $1,128,883. Both volume of sales and net income have, however, declined from the peak. On its capital investment the group has received dividends in debentures in the amount of $499,157, the initial capital has been repaid and it retains an equity with a book value of $26,917.

U. *A correspondence school for accounting.*—This business is still in the development stage and has had as yet only a very small income. Its prospects, however, are good. The group has invested $150,682 and advanced loans to the amount of $190,000. For its investment the group received $148,200 in preferred stock and 1,482 shares, or 59.3 percent, of the common stock. The volume of business reached a peak of $547,138, but because of high development costs, net income was only $1,836. In calculating its assets the company excludes $448,972 of collectible students' tuition, and consequently reports net worth as a deficit of $71,630. However, collectibles in the amount of $527,703 are held and using the management's conservative collection ratio of 50 percent, the book value of the group equity is $152,856.

V. *A company engaged in the promotion of soybean products.*—Members of the group advanced $30,000, for which they received $30,000 of convertible 5-year 6-percent notes with purchase warrants attached. Conversion of the notes and exercise of the warrants would give the group members 91.8 percent of the equity. The company has assets of $58,101. As the company has been formed only recently no operating or production statistics are available.

W. *A corporation manufacturing a patented bag-closing device.*—The company was operating without sufficient capital to attain quantity production. A new corporation was set up and members of the group advanced $5,000 in the form of a loan to enable the company to fill orders already received. As a bonus for the advance, they received 500 shares, or 50 percent, of the common stock. Holders of preferred stock in the original corporation were given an equivalent amount of preferred stock in the new corporation.

VIEWPOINT OF A CONSERVATIVE COMMERCIAL BANKER

As commercial bankers have frequently been criticized for not lending their depositors' money more freely to the smaller types of enterprise, the following interview with an experienced banker may not be amiss. This banker spoke with extreme frankness concerning the financial problems of small business with the understanding that his identity would not be disclosed. Commercial bankers, like other men, vary considerably in their attitudes; the following interview, while it may not be typical of the views of all commercial bankers, nevertheless embodies a point of view which was encountered frequently during the course of the field studies. The summary is based on notes made during the conversation.

Did you see that man who just went out? I have just made him a loan on his receivables. I know him thoroughly, have known him for years, and I am taking his word that his receivables are as he says and are all right. This is not sound banking and I ought not to do it. As a favor to him, I am not letting his customers know that the receivables are assigned. I am trusting him to collect for me. This is not sound banking either.

I don't do much of this. The risk is too great. No, a 10-percent Federal guaranty wouldn't cover that risk, with the bank risking 90. I would still have to know enough about the man to be sure I could trust him.

It is perfectly true that, here and all over the country as far as I know, undue credit is extended to purchasers, and in turn passed on up to wholesalers and producers. But it is not right or reasonable that banking should assume the risk involved in liquidating that situation. Who would profit? The retailer and the wholesaler—not the bank. The bank is asked to perform a costly charity and is criticized if it does not do so. This is unsound.

Don't forget that the small businessman takes out plenty of withdrawals for his personal enjoyment the moment things are going easily with him. And as soon as his credit difficulties are untied he starts to expand unwisely and gets vainglorious. Now the Federal Government seems to think we ought to finance that sort of thing. I have been in this business for many years and there isn't anything you can tell me about human nature. I've learned in the school of experience what these fellows do the moment you let down the bars. Always it is the bank that is stuck.

A small manufacturer here has just cost me $9000. He lied on paper and we didn't catch it. Another manufacturer lately stuck another bank and myself for $1,500 apiece. Money had been unsoundly sunk in expansion, and used up in withdrawals, which ought to have gone into liquidity. I talked to this man like a Dutch uncle but I think he feels bright about having stuck the bank. There are other cases in which I have got behind developing concerns and seen them through until they were successful and established; in the course of such an association there will always be some occasion where you have to refuse something they want. This is remembered, when the risk you have taken is forgotten, and in the end, when established, the client takes his banking elsewhere.

I have no criticism of informal loan concerns that charge 20 and 30 percent and get anything they can and please. The risk they take is commensurate with those rates. They are in that kind of a game. The banks are not. Banks do not exist to unfreeze those who are and will again be frozen due to their own folly. I know that these loan concerns do a considerable business and I do not begrudge them a cent of it. They make the book and they are entitled to collect the winnings. That is gambling, not banking, and the entire set up, lender and borrower alike, is on the gambling level. Is the Government going to get behind of and uphold the hands of the conscienceless and gambling type of borrower? If so, the Government will get stuck, plenty, and I suppose the banks will ultimately pay for it in the form of added taxation. It will amount to supporting illicit and unsound transactions out of the savings of the sound portion of the economic world. No formula can be devised, in addition to the rightful accommodation to proper business that is now being extended, that will not simply lead to insane expansions, unjustifiable withdrawals for personal use, squandering, and huge losses, for which the taxpayer must be penalized.

Certain banks do a large personal-loan business on a co-maker basis. That meets the business need of the little man as far as it should be met. The wholesaling concerns stand behind the unsound merchant, and underwrite the risks he takes, and if they see fit to do so that is all right—again, the risk is theirs. But it should not be the banks, or the Government.

It all goes back to the lack of integrity of the ultimate consumer and the readiness with which he can get credit for purchases he ought not to make. As to F. H. A. loans—people would now get houses on credit, in which they do not own enough equity to be riskworthy, if the banks did not examine into such cases and use their own discretion anyway about extending the housing loans. We made some loans under the 20 percent F. H. A. guaranty and in some cases got stuck for the 80. Under the 10 percent guaranty we risk the 90, and losing 90 percent is not banking, it is folly.

Steady, reliable business is creditworthy and it readily receives credit. We must select the acorns that grow into oaks. To put money into the hands of the rest is to drive sound business to the wall and lead us God knows where. The best service the banks can render is to protect their depositors' funds and to aid only the rightly managed enterprise. We cannot finance the unsound at the expense of the sound.

LEGISLATIVE PROPOSALS

The following bills bearing on the financing of small business were introduced in the Seventy-sixth Congress, first session:

In the Senate.

S. 1203. Mr. Pepper, February 6, 1939 (Banking and Currency):

Would establish a system of regional industrial banks, up to 12 in number, with the following powers:

1. Each would begin business with capital stock of $100,000,000, subscribed by the Secretary of the Treasury, which could be increased to $1,000,000,000. Stock open to public subscriptions as determined by board.
2. Each would have authority to make loans with or without collateral at rates of interest determined by the board.
3. Each bank might establish subregional banks.

S. 1482. Mr. Mead, February 17, 1939 (Banking and Currency):

The Reconstruction Finance Corporation would be authorized to insure banks against losses sustained as a result of loans made by them, between July 1, 1939, and July 1, 1941, to any industrial or commercial business to enable it to extend operations or to modernize its plant.

Such loans would not be insured (1) if in excess of $200,000, (2) if not amortized so as to repay principal and interest in less than 7 years, (3) if interest charge (exclusive of premiums) were in excess of 4 percent of outstanding principal, (4) if service charges were in excess of 1 percent per annum of original amount, (5) if not secured by first mortgage on real estate or chattel mortgage on personal property, determined by corporation to be valued at 125 percent or more of principal obligation.

The annual insurance premium charge would be between one-half and 1 percent of original amount of loan.

Insured loans could be sold to or discounted by other banks and might be discounted by Federal Reserve bank of district.

S. 1743. Mr. Logan, March 8, 1939 (Banking and Currency):

Federal Investment Bank Act of 1939: Offers a system of credit banks for independent small business. A Federal investment bank board would divide the United States, its Territories and possessions into not more than 20 Federal investment-bank districts. The board

would serve also as a board of trustees for the Federal Investment Insurance Corporation set up to insure members and investors in Federal investment associations up to $5,000.

There would be a Federal investment bank in each district with a capital of not less than $5,000,000 or more than $10,000,000. Such banks would discount notes, etc., of Federal investment associations up to 90 percent of their face value at a rate of not more than 5 percent per annum. Capital would be raised by public offerings of stock. An appropriation of $120,000,000 would be made available through the Reconstruction Finance Corporation for the purchase of unsold stock.

Local investment associations of independent small businessmen organized on a pattern similar to that of Federal savings and loan associations could borrow from investment banks when credit of the type applied for was not available through the usual local commercial banking channels, and could make loans within a radius of 50 miles for sums not exceeding $100,000 to any one borrower, at not more than 6 percent on unpaid balances.

The Board, with the approval of the Secretary of the Treasury, might authorize the banks to issue notes, debentures, bonds, and other consolidated obligations to mature in not less than 10 years in amounts not to exceed 12 times subscribed capital of issuing banks.

Capital of the Insurance Corporation would be $100,000,000, subscribed by the Reconstruction Finance Corporation.

S. 2343. Mr. Mead, May 8, 1939 (Banking and Currency):

Insured Business Loans Act: The Reconstruction Finance Corporation would be authorized to insure any bank (whose deposits were protected by the Federal Deposit Insurance Corporation) against loss in excess of 10 percent of the principal amount of any loan which such bank might make for a business purpose (the Reconstruction Finance Corporation to determine what constitutes a business purpose). The insurance premium would be between one-fourth of 1 percent and 1 percent of the unpaid balance of the loan, provided that the premium might be higher or the insurance might be refused, if the Reconstruction Finance Corporation determined that the applying bank insures only its more doubtful accounts. Among the restrictions placed upon loans would be (1) a term of more than 1 year and not more than 10, not bearing interest in excess of 4 percent on unpaid balances or carrying a service charge fee or commission of more than one-fourth of 1 percent; (2) borrower's insured indebtedness must not exceed $1,000,000. Loans would be eligible for rediscount with Federal Reserve banks.

S. 2580. Mr. Hill, June 8, 1939 (Banking and Currency):

Would create Federal Business Finance Corporation, capital stock not to exceed $100,000,000 to be subscribed for by Reconstruction Finance Corporation. Would be managed by three directors appointed by the Reconstruction Finance Corporation. Authorized to make loans to business enterprises and to purchase their securities, debentures, capital notes (which may be subordinate to other obligations), and preferred stock. Loans would be made for providing working capital, for capital expenditures and construction, for the retirement, funding, and extension of existing indebtedness and other business purposes when repayment may reasonably be expected on the basis of prospective earnings. However, the Corporation could im-

262652—41—No. 17——25

pose conditions with respect to compensation of officers, directors, and employees of the applicant, and such other terms as it deemed necessary. The aggregate amount of loans to one business would not exceed $1,000,000.

The Corporation would limit its outstanding debentures and other obligations to not more than five times its subscribed and outstanding capital, but its obligations would be fully guaranteed as to principal and interest by the United States. The Secretary of the Treasury would be authorized to purchase and sell obligations of the Corporation as a public-debt transaction.

In the House.

H. R. 4280. Mr. Allen of Pennsylvania, February 17, 1939 (Banking and Currency):

Would provide insurance by the Reconstruction Finance Corporation of operation and modernization bank loans to industry—similar to S. 1482 with an additional provision which qualified such loans if secured by debentures which could be amortized in 10 years.

H. R. 4851. Mr. Patman (by request), March 8, 1939 (Banking and Currency):

Federal Investment Bank Act: Similar to S. 1743 as introduced.

H. R. 4857. Mr. Voorhis of California, March 8, 1939 (Banking and Currency):

Federal Investment Bank Act: Similar to S. 1743 as introduced.

H. R. 4858. Mr. Allen of Pennsylvania, March 8, 1939 (Banking and Currency):

Regional industrial banks: Similar to S. 1203 as introduced.

H. R. 5534. Mr. Reed of Illinois, April 4, 1939 (Banking and Currency):

The Federal Industrial Loan Insurance Act would create the United States Industrial Corporation with capital of $100,000,000 subscribed for by the Secretary of the Treasury. The principal office would be in the District of Columbia and branch offices in each Federal Reserve city, with such additional branches as the Board deemed necessary, but not more than one in each State. Twelve directors would be appointed by the President. In each Federal Reserve district there would be a technical advisory committee composed of members of at least 10 years' practical industrial executive experience, which would pass upon the merits of loans and collateral. The Corporation would be authorized to guarantee to any Federal Reserve bank, National or State bank, payment of principal and interest upon any note or other evidence of indebtedness issued for industrial purposes. In general, these purposes would be: (1) Warehouse receipts, (2) purchase of new equipment for industrial plants, (3) new construction and remodeling of plants, (4) additional working capital. Certain qualifications are placed upon each category and guaranties would be limited to $250,000 to any one borrower. No paper would be guaranteed if it bore interest upon unpaid principal or were discounted at a rate in excess of 6 percent. Paper could not be of more than 15 years' maturity and would have to be adequately insured in the opinion of the technical advisory committee. A charge of 2 percent per annum on unpaid principal balance would be made by the Corporation. Federal Reserve banks would be authorized to discount at not more than 3 percent per annum, notes guranteed by the Corporation.

H. R. 5910. Mr. Voorhis of California, April 20, 1939 (Banking and Currency):

Industrial Finance Act: Would provide an Industrial Finance Board of five members to supervise industrial-finance banks, one of which would be established in each industrial-finance-bank district, not to exceed 15.

The banks would be managed by boards of nine directors. The capital for each bank would be obtained from the sale of stock to private individuals, the Reconstruction Finance Corporation and other agencies. Additional funds for the use of such banks would be raised by the Board through consolidated-industrial-finance bank debentures (joint and several obligations of all the banks), up to 15 times the total paid-in of all industrial-finance banks, which would be marketed by the Secretary of the Treasury. Such debentures would be guaranteed by the United States as to principal and interest.

These banks would endeavor to maintain and increase employment by making loans to or purchasing obligations of producers or marketers of goods or services, whenever credit was not available from private sources. Loans and discounts may be for a period of 5 years and may be extended for another 5 years. They may be paid off with consolidated industrial-finance-bank debentures at face value, and may be rediscounted at the Federal Reserve banks.

The banks would be authorized also to underwrite securities of producers or marketers unable to obtain financing, through private investment bankers. Whenever credit such as they would furnish became available through private channels, they would be liquidated.

H. R. 6250. Mr. Schwert, May 9, 1939 (Banking and Currency):

Insured Business Loans Act: Similar to S. 2343 as introduced.

H. R. 6448. Mr. Sabath, May 22, 1939 (Banking and Currency):

Credit Expansion Act: Any person requiring credit to finance production or distribution of goods would make application to the corporation (any agency subject to the supervision of the Federal Loan Administrator and designated by him) for the appointment of a production and credit trustee. In addition to the applicant, all persons from whom he intended to purchase materials would have to sign the application, and one of them would be designated trustee for the deal, if he qualified under standards established in the bill. The trustee would issue secured trustee certificates bearing 4 percent interest in payment for material, labor, etc., needed to carry out the underwritten transaction. Certificates would be negotiable and would be discountable by the Corporation at the request of any holder; rediscountable by the Federal Reserve banks. Such certificates would be superior liens (notwithstanding the Bankruptcy Act) on the assets involved in the transaction. The trustee would receive all income from the transaction, repay creditors, and transfer any residue to the applicant. He could accept no fee.

H. R. 6790. Mr. Sabath, June 12, 1939 (Banking and Currency):

Credit Expansion Act: This bill was a modification of H. R. 6448. Under its provisions the creditors would designate the prospective trustee, but he would not necessarily be one of their number. The corporation could not deny the registration of a transaction if the credit required did not exceed $25,000, unless the transaction were considered fraudulent or illegal, or the proposed trustee were considered unfit for trust. The persons supplying credit would call upon the corporation

to issue trustee certificates at the direction of the trustee under stipulated safeguards.

H. R. 3520. Mr. Brown of Ohio, January 31, 1939 (Banking and Currency):

This bill would amend section 24 of the Federal Reserve Act to permit banks to make capital loans. It stated specifically conditions under which national banks could make loans to businesses to acquire land, machinery, fixtures, or other tangible capital assets. It would limit such loans to 80 percent of appraised value (or not to exceed $500,000). Such loans could not be for longer than 10 years, and their aggregate amount might not be in excess of the amount of capital stock plus unimpaired surplus, or in excess of 60 percent of time and savings deposits, whichever was greater. Previous limitations imposed by section 24 would not apply to loans made under this paragraph.

H. R. 5429. Mr. Jeffries, March 29, 1939 (Banking and Currency):

Would empower Reconstruction Finance Corporation to guarantee up to 90 percent of face-value character loans to merchants by local banks and by Federal Reserve banks in amounts not exceeding $2,500 at interest of not more than 6 percent. Promissory notes of not more than 7 years' maturity would be guaranteed under stated restrictions as to the stability and character of the borrower. The Reconstruction Finance Corporation might not guarantee more than $1,000,000,000 of such notes. The bank making the loan would pay the Reconstruction Finance Corporation 2 percent interest on the amount of the loan outstanding as a service charge.

H. R. 7291. Mr. Voorhis (by request), July 19, 1939 (Ways and Means):

Would authorize underwriting by the United States of loans for pay rolls of farming, mining, productive industry, and trade in tangible goods. Under title I the Federal Deposit Insurance Corporation would certify eligibility under Federal Deposit Insurance Corporation rules of banks to make loans for payment of wages not exceeding $3,000 a year for any one employee. Loans would be secured by commercial paper or collateral which in the judgment of the lending bank best served the purpose of the act and insures self-liquidation of the loan. Banks would be entitled to reimbursement from the Secretary of the Treasury upon order of the Federal Deposit Insurance Corporation for defaulted loans, but in any year such reimbursement could not exceed one-fifth of the monthly average principal sum of credits advanced.

The law would provide for a pay-roll credit currency to be accounted for by banks separately from other currency. Every person and corporation receiving such currency in payment of goods would be required to keep a separate account of it.

The Federal Deposit Insurance Corporation would be directed to establish agencies wherever needed and in the absence of an eligible bank to make direct pay-roll credit advances.

Title II would provide a recapture tax of 100 percent on all individual incomes received in pay-roll credits in excess of $10,000 a year. It would also impose a recapture tax upon persons and corporations equal to the full amount of the net profits of business done for and in consideration of pay-roll credits; such tax to be calculated by deducting from total gross sales made for pay-roll credits a like

proportionate part of the deductible expenses of the taxpayer, but such proportionate part of expenses would not include payment for personal services at a greater rate than $10,000 a year for one person.

SECOND SESSION, SEVENTY-SIXTH CONGRESS

In the Senate.

S. 2998. Mr. Mead, October 31, 1939 (Banking and Currency):

Industrial Loan Corporation Act: Would create the Industrial Loan Corporation to be managed by the Board of Governors of the Federal Reserve System and to have the use of Federal Reserve bank facilities. It would take over and expand the direct loan functions of the Federal Reserve banks, but might also establish independent branch offices and designate other institutions as its agents. The bill calls for encouragement by its board of the formation of groups of local small businessmen to advise and assist prospective applicants for loans.

The bill would implement the Corporation with most lending and discounting functions of commercial banks, but would set a 10-year limitation upon loan maturities. The Corporation could purchase preferred stock in commercial or industrial enterprises, or discount such stock for financial institutions, or make loans to financial institutions on such security; but the preferred stock would have to be retired within 10 years of purchase, or 40 percent of its face value would have to be amortized in 10 years.

A limit of $1,000,000 outstanding advanced to any one company would be imposed, and aggregate obligations of the Corporation might not exceed $500,000,000. Notes, debentures, bonds, etc., guaranteed by the United States as to principal and interest would be issued to finance the Corporation. A reserve not exceeding $25,000,000 would be set aside for insuring banks against loss from paper acquired under the act, but no insurance would be granted to any one bank with respect to obligations of one obligor in excess of $25,000.

Funds would be provided through purchase by the Secretary of the Treasury from the Federal Reserve banks of stock of the Federal Deposit Insurance Corporation held by them, the Treasury to use its gold revaluation "profit" for the purpose. Capital stock of the Corporation would be $100,000,000 and the remainder of money received initially from the Treasury would constitute paid-in surplus. The Corporation would be a depositary of public money when so designated by the Secretary of the Treasury. It would be liquidated when there was no longer reasonable need for its continuance.

Third session, Seventy-sixth Congress:

THIRD SESSION, SEVENTY-SIXTH CONGRESS

In the Senate.

S. 3343. Mr. Mead, February 13, 1940 (Banking and Currency):

Would liberalize section 13B of the Federal Reserve Act (Direct Loans Act of 1934). A business to receive a Federal Reserve bank loan would not have to be an established enterprise, and its obligations purchasable by the bank might run for 10 years instead of 5 years. Member banks making loans would be required to obligate themselves for only 10 percent of the loan, instead of 20 percent.

When funds stipulated for such loans were exhausted, Federal Reserve banks might utilize other funds until their total equaled amounts received for purposes of the act from the Secretary of the Treasury. Section 13B (d) of the present law calling for industrial advisory committees would be omitted. The amendment also would abolish 2 percent interest to the Treasury on sums advanced for the purposes of the act.

S. 3511. Mr. Pepper, March 4, 1940 (Banking and Currency):

Industrial Loan Corporation Act: This was a modification of S. 2998. It does not specifically mention purchase by the Industrial Loan Corporation of preferred stock and would reduce the amount which might be advanced to any one borrower at one time from $1,000,000, proposed by Mr. Mead, to $25,000. It omitted the power of the Corporation to issue obligations up to $500,000,000.

S. 3839. Mr. Mead, April 24, 1940 (Banking and Currency):

Amends section 13B of the Federal Reserve Act to permit, under exceptional circumstances, a Federal Reserve bank to make loans to, or purchase obligations of, or make commitments with respect thereto, of business enterprises unable to obtain financing elsewhere. It also permits a Federal Reserve bank to discount for, or purchase from, any bank, trust company, mortgage company, credit corporation for industry, or other financing institution operating in its district, obligations of any business enterprise.

In the House.

H. R. 8536. Mr. Barry, February 19, 1940 (Banking and Currency):

Similar to S. 3343 calling for liberalization of direct loans by Federal Reserve banks.

H. R. 8623. Mr. Thomas F. Ford, February 23, 1940 (Banking and Currency):

Similar to S. 2998, introduced by Mr. Mead in the Senate on October 11, 1939.

H. R. 8731. Mr. Sabath, March 1, 1940 (Banking and Currency):

Similar to S. 2998, but inserts an additional section providing essential features of H. R. 6790 calling for creation of a system of production and credit trustees.

INDEX

ABRAMSON, VICTOR, *joint author.* (*See* Lyon, Leverett S., and others.)

ACCOUNTING:

Bankruptcy cases: Page

Adequacy of records, New Jersey and Boston firms compared by business types; comment and table 95 ... 85–86

Costs of operation. (*See* Costs of Operation)

Ratio analysis of assets and liabilities ... 97–104

ACCOUNTS FINANCING COMPANIES: Function and operation of ... 270–272

AGRICULTURAL MACHINERY WHOLESALE CONCERNS: Life span.

Minneapolis and St. Paul ... 51

AKRON, OHIO:

Tenancy—business property:

Fluctuations, square feet of rental area changes, between October 1, 1938, and May 1, 1939, table 92 ... 70–71

APPAREL RETAILERS: (*See* Clothing Retailers.)

ASSETS AND LIABILITIES: Control analysis ... 97–104

Ratio comparisons, failed and successful concerns, piano manufacture, 1926, 1928–29; comment and table 102 ... 97

AUSTIN, TEX.:

Grocery stores:

Life expectancy, percentage chance of continuing in business a given number of years at given age of business; table 56 ... 43

Life expectancy, survivals out of 1,368 stores by number of years, 2 to 35; table 55 ... 43

Mortality, accumulated percentage by year periods, 2 to 35 years, between 1880 and 1932; comment and table 13 ... 17

Mortality, closures during period 1880–1932 as percent of stores at beginning of each period; comment and table 29 ... 26

Mortality, total mortality, 1-to-2-year-olds mortality, percent latter, of total, 1884–85, 1896–97, 1906–07, 1913–14, 1921–22, 1928–29; comment and table 34 ... 28

Mortality rate, 1882–1932; rate of 1-to-2-year-old stores; percent of latter to total rate; table 21 ... 22

Mortality rate decrease of 1-to-2-year-olds in decline period of depressions of 1892–93, 1896–97, 1906–07, 1913–14, 1921–22, 1928–29; table 32 ... 28

Mortality rate increase of 1-to-2-year-olds in depression recovery periods of 1894–95, 1898, 1908–09, 1915–16, 1923–24; table 33 ... 28

Mortality rate, of 1- and 2-year-old stores; 1882–1932; comment and table 20 ... 21

AUTOMOBILE DEALERS:

Credit loss ratio ... 129

AUTOMOBILE INDUSTRY:

References to literature. (*See* References to Literature and Sources, items 32, 34, 35.)

AUTOMOBILE MANUFACTURING CONCERNS:

Life span:

United States, average longevity during period 1903–26 ... 47

AUTOMOBILE RETAILERS:

Life span:

Minneapolis and St. Paul; 5-year turn-over ratio and average life in years, 1926–30; table 5 ... 11

AUTOMOTIVE PRODUCTS RETAILERS:

Failures:

Number of failures, amount of liabilities, each year 1938 and 1937; table 89 ... 68

AUTOMOTIVE PRODUCTS WHOLESALERS:
Failures: Page
Number of failures, amount of liabilities, each year 1938 and 1937; table 89 ... 68
AVERY, HAROLD G.: Some aspects of grocery-store failure (1926); cited (n.) ... 90
AXIAS: Loans outstanding, 1938; table 20 ... 221
AYERS, SOLON: A study of mortality of retail grocery stores in Austin, Tex., from 1880 to 1932; cited (n.) ... 7, 17, 26, 37, 71, 115
BAD-DEBT LOSSES. (*See* Credit Losses.)
BANKRUPTCIES:
Accounting records:
New Jersey and Boston firms, as to adequacy by business types; comment and table 95 ... 85–86
Capital source:
New Jersey and Boston bankrupts, original capital, by sources, percentages of total; comment and table 99 ... 93–94
Capital-use analysis ... 95–96
Chicago:
Analysis of liabilities of bankrupts ... 92
Location drawbacks ... 120
Credit factor ... 127–134
Credit losses:
Boston, bad-debt losses as percent of total credit sales, by business groups: manufacturers, wholesalers, retailers; table 122 ... 130
Fraudulent use of funds ... 87–88
Investment problems ... 88
Liabilities:
Percentage of amounts of total liabilities in particular debt categories, individual proprietors; table 98 ... 93
Life span relationship:
Chicago, 709 concerns, 1930–31 ... 54
Chicago, 1,012 concerns, form of organization percentages ... 59
Liquidations:
Liabilities, assets realized, total paid to creditors, expenses of liquidation, percent of liability paid, cents of liquidation per dollar of total assets realized, total number of cases, number of no-asset cases, ratio of no-asset cases to total, each year 1920 to 1937; table 90 ... 69
Personal affairs factor:
Percentage of bankrupt concerns affected by adverse domestic and personal factors, by field of business; comment and table 129 ... 135
Philadelphia; citation ... 90
References to literature. (*See* References to Literature and Sources, items 7, 29.)
BANKS AND BANKING:
Federal Reserve banks. (*See* Federal Reserve Banks.)
Small business, credit extension by commercial banks ... 265–269
Small business, part of investment banking in financing of ... 263
State bank failures. (*See below* References to Literature and Sources, item 81.)
BARBERS' CRAFT:
Life span, Poughkeepsie, N. Y., years of life, 1 to 10 and over, of barbers established between 1844 and 1926; percentage distribution; table 16 ... 19
BEACON FALLS RUBBER SHOE CO.: Failure analysis ... 90
BERLE, A. A., Jr.:
Memorandum of suggestions; investigation of business organization and practices (1938); extract (n.) ... 257
Proposal for creation of a capital-credit banking system as a supplement to the existing banking structure; cited ... 278
BERLE, A. A., Jr., and MEANS, GARDINER C.: The Modern Corporation and Private Property (1934); cited (n.) ... 142

BIRTHS IN BUSINESS POPULATION:
Industrial divisions: Page
Birth rate ranking of divisions of industry, by types of business, January–June 1936; comment and table 85 ... 65
Percentage distribution of births and deaths, January–June 1936; comment and table 83 ... 64
BODDY, F. M., *joint author.* (*See* Garver, F. B., and others.)
BODER, LOUIS: Recent Price Legislation and Economic Theory (1938); cited (n.) ... 105
BOER, A. E.: Mortality Costs in Retail Trades (1937); cited (n.) ... 27, 41, 82, 90
BOSTON, MASS.:
Bankruptcies:
Accounting records of firms by type of business, compared with New Jersey firms; table 95 ... 86
Capital source, New Jersey and Boston compared, original capital, by sources, percentages of total; comment and table 99 ... 93–94
Credit losses as percent of total credit sales, by business groups; manufacturers, wholesalers, retailers; table 122 ... 130
Grocery stores—chain:
Turn-over, closing and opening rates for chain stores, 1929–30; number of stores first of year, number closed in year, number added in year, net change, number stores in business during year, turnover rate 2 to 5, closing rate 2 to 1, opening rate 3 to 1, average number of stores during year, turn-over 2 to 9, table 15 ... 18
Retail trade competition ... 123
BRAND PREFERENCE ... 125
BROWN, EDWARD E.: Testimony before United States Senate Banking and Currency Committee on Mead bill, S. 1482, Seventy-sixth Congress (1939); extracts ... 227, 239
BUFFALO, N. Y.:
Drug stores:
Life span, percentage discontinuing in each successive year, first to ninth, by year of entrance, 1919–27; comment and table 26 ... 24
Grocery Stores:
Life span, 1919–27; comment and table 2 ... 9
Life span, percentage discontinuing in each successive year, first to ninth, by year of entrance, 1919–27; comment and table 25 ... 24, 28
Present ownership date distribution; comment and table 12 ... 16
Sales, independent stores in 1929, dollar amount, according to years of ownership, 1890–1929; comment and table 41 ... 33
Sales: independent stores, sales volume in 1933 and 1935, percent of 1929, by size of business in 1929; comment and table 43 ... 35
Sales, number of independent stores, percent of total stores, percent of total sales, 1929, 1933, 1935, by amount of sales; comment and table 42 ... 34
Hardware stores:
Life span; percentage discontinuing in each successive year, first to ninth, by year of entrance, 1919–27; table 27 ... 25
Milling city ranking successor to Minneapolis, 1930 ... 119
Retail concerns:
Life expectancy, years 1 to 10, 1920–28, by trades; table 53 ... 42
Mortality, 1918–27: grocery, drug, hardware, and shoe stores, percentage going out of business of total number in business each year; table 30 ... 27
Tenancy-business property:
Fluctuations, square feet of rental area changes between October 1, 1938, and May 1, 1939; table 92 ... 70–71
BUILDERS. (*See* Carpenters and Builders.)
BUILDING MATERIALS, RETAILERS:
Life span:
Minneapolis and St. Paul; 5-year turn-over ratio and average life in years, 1926–30; table 5 ... 11
Profits:
Percentage of total capital, 1924–28; comment and table 15 ... 186–187

BUREAU OF FOREIGN AND DOMESTIC COMMERCE:
Domestic Commerce Series: Page
No. 54. Causes of business failures and bankruptcies of individuals in New Jersey in 1929–30; cited (n.) ---------------- 93, 123
No. 59. Causes of failure among drug stores (1932); cited (n.) and extract ---------------- 81, 94, 123, 127
No. 69. Causes of commercial bankruptcies (1932); cited (n.) and extract ---------------- 89, 123
Trade Information Bulletin:
No. 627. Credit extension and business failures (1930); cited (n.) ---------------- 93
No. 700. Credit extension and causes of failure among Philadelphia grocers; cited (n.) ---------------- 92
BUSINESS CONDITION, FIELD SURVEYS. (*See* Denver, Colo., Detroit, Mich., Fall River, Mass., Houston, Dallas, and Fort Worth, Tex., Omaha, Nebr., Scranton and Wilkes-Barre, Pa., Seattle, Wash., and Portland, Oreg.)
BUSINESS ORGANIZATION. (*See also* Corporations):
Form of:
Interchange of proprietorships, partnerships, and corporations by manufacturing, wholesale, and retail concerns, percentage distribution, January–June 1936; table 80 ---------------- 61–62
Percentage distribution, January–June 1936, of interchange of proprietorships, partnerships, and corporations, by type of business, 77,000 case records; comment and table 80 ---------------- 60–61
Poughkeepsie, percent each type of organization (independent, partnership, corporation, all other) of 12,618 firms, by type of business; comment and table 78 ---------------- 59–60
Poughkeepsie, percent each type of organization of 12,698 firms, by type of business; comment and table 78 ---------------- 59–60
Poughkeepsie, percent each type of 12,618 firms, by type of organization (independent, partnership, corporation, all other); comment and table 78 ---------------- 59–60
BUSINESS POPULATION:
Births: (*See* Births in Business Population.)
Construction industry. (*See* Construction Industry.)
Crafts. (*See* Crafts.)
Failures. (*See* Failures.)
Investment. (*See* Investment Concerns.)
Life span. (*See* Life Span.)
Manufacturing concerns. (*See* Manufacturing concerns.)
Mortality. (*See* Mortality in Business Population.)
Net worth relationships. (*See* Net Worth.)
Number of establishments in relation to population, 1901–38; index of number per 1,000 population 1901 and 1926 base, table 11 ---------------- 290
Number of establishments, statistics and discussion ---------------- 282–283
Organization types. (*See* Corporations; Business Organization.)
Retail concerns. (*See* Retail Concerns.)
Service establishment. (*See* Service Enterprises.)
Size of concerns. (*See* Size of Business Enterprises; Small Business.)
Tenancy fluctuation. (*See* Tenancy.)
Turn-over. (*See* Turn-over.)
Wholesale. (*See* Wholesale Concerns.)
Butcher Shops. (*See* Meat Retailers.)
CALIFORNIA: Fair Trade Law 1931, with amendment of 1933; text and analysis ---------------- 196–198
CAPITAL MARKET:
Great Britain. (*See below* References to Literature and Sources, items 50, 51.)
CARPENTERS AND BUILDERS:
Failures, number of failures, amount of liabilities, each year 1938 and 1937; table 89 ---------------- 68
CASSADY, RALPH, JR.: Maintenance of Resale Price by Manufacturers (1939); cited (n.) ---------------- 194, 199
CENSUS BUREAU:
Census of business for 1935 ---------------- 281
Census of manufactures for 1937 ---------------- 281

CHAIN STORES: Page
Compared with independent meat markets and combination stores; table 128 — 133
Contribution of, to more efficient retailing system — 178–179
Future of, Nystrom's opinion — 176
Life span, supermarket relationship — 40–41
Number and percent of total stores, percent of total sales, by gross sales classes, 1935; table 13 — 217
Opposition to — 147
References to literature. (*See below* References to Literature and Sources, items 36, 37, 47, 76.)
Sales:
Number of chain stores and full-year sales, by size of store; comment and table 9 — 178
Percent of total: grocery and combination stores, chain drug stores, all kinds of business; comment and chart 4 — 176–177
Tax discrimination laws — 202
CHAMBER OF COMMERCE OF THE UNITED STATES: Community Industrial Financing Plans (1936); cited (n.) — 263
CHEMICAL AND DRUG MANUFACTURING CONCERNS:
Failures:
Number of failures, amount of liabilities, each year 1938 and 1937; table 89 — 68
Profits:
Percentage of total capital, 1924–28; table 13 — 186
CHEMICAL AND DRUG WHOLESALE CONCERNS:
Failures:
Number of failures, amount of liabilities, each year 1938 and 1937; table 89 — 68
CHICAGO, ILL.:
Bankruptcies:
Analysis of liabilities of bankrupts — 92
Life span, form of organization percentages — 59
Life span relationship, 709 concerns, 1930–31 — 54
Liquidation experience Chicago firms, 1930 — 26
Meat stores:
Life expectancy: independent meat and combination stores, 1920–33, percentage of total number continuing for 1 to 5 years; comment and table 57 — 44
Life span, percentage continuing in business over 5 years, by capital-rating groups; comment and table 96 — 89
Life span, percentage discontinuing in each successive year, 1st–12th, by year of entrance, 1921–32; comment and table 24 — 23
Mortality, 1922–33; Greer study; cited (n.) — 9
Mortality of 1-year-olds; straight and combination stores, discontinuance percent of total entries, 1921–32; comment and table 23 — 23
Net worth, percent of total in each net-worth group, percent in business in 1920, continuing more than 5 years, average length of life of stores in business in 1920, by net worth; comment and table 40 — 32
Population per store: number of retail stores and per thousand population, by type of operation independent 1920–33, chain store and all retail 1929–33; comment and table 47 — 37–38
Turn-over of independent stores: number of entrances, total number in business in year, number of closures, number at end of year, net change, percent to total entrances and closures, year ending July 1, 1920–33, and average for period; comment and table 22 — 22
Turn-over rate of meat markets and combination stores, respectively, 1921–33; comment and table 18 — 19–20
Packing houses:
Credit losses, number and amount according to length of service; comment and table 124 — 131
Credit losses, number and amount, 3 branch houses, 5-year period, comment and table 123 — 130
Tenancy-business property:
Fluctuations, square feet of rental area changes between October 1, 1938, and May 1, 1939; table 92 — 70–71

CIGAR STORES: Page
Life span: Poughkeepsie, N. Y., percentage of concerns discontinuing at given age, 1 to 10 years and over, of 230 established between 1844 and 1926, table 7 ... 13
CLEANING AND DYEING ESTABLISHMENTS:
Failures:
Number of failures, amount of liabilities, each year 1938 and 1937; table 89 ... 68
CLEVELAND, O.:
Tenancy-business property:
Fluctuations, square feet of rental area changes between October 1, 1938, and May 1, 1939; table 92 ... 70–71
CLOTHING MANUFACTURING CONCERNS:
Life span:
Minneapolis, St. Paul, and Duluth, 1925–30 ... 46
CLOTHING RETAILERS (*See also* Men's Wear Stores; Women's Wear Stores):
Failures:
Number of failures apparel trade, amount of liabilities, each year 1938 and 1937; table 89 ... 68
Life span:
Minneapolis, St. Paul and Duluth; 5-year turn-over ratio and average life in years (women's clothing respectively), 1926–30; table 5 ... 11
Mortality:
Colorado towns, cumulative percentages of 20 dealers commencing business in 1927, gone in successive years, 1928–35, table 8 ... 13
Colorado towns, 142, cumulative percentages of 239 dealers in 1926, gone in successive years 1927–35; tables 9, 11 ... 14–15
Illinois towns, 255, cumulative percentages of 533 stores in July 1925, gone in successive years, 1926–30; tables 10–11 ... 14–15
Population per store:
Colorado towns, 142, number per 1,000 population in 1929 and 1935, by size of town; table 48 ... 39
Illinois towns, 154, number per 10,000 population in 1925 and 1930 by size of town; table 49 ... 39
CLOTHING WHOLESALE CONCERNS:
Failures:
Number of failures, amount of liabilities, each year 1938 and 1937; table 89 ... 68
Life span:
Minneapolis and St. Paul ... 51
COLORADO:
Failures, 1900–26, compared with national series; comment ... 71
Retail concerns:
Mortality, 142 towns, cumulative percentages of 3,587 dealers in business in 1926, gone in successive years 1927–35, by trade; comment and table 9 ... 14
Mortality in 142 towns, cumulative percentages of dealers commencing business in 1927, gone in successive years 1928–35; comment and table 8 ... 13
Mortality, 142 towns, cumulative percentages of dealers in business in 1926, gone in successive years 1927–35, by size of town; comment and table 36 ... 30
Population per store, 142 towns, number per 1,000 population in 1929 and 1935, by size of towns and by trades; comment and table 48 ... 39
COLUMBIA GRAMOPHONE MANUFACTURING CO.: Failure analysis ... 90, 96
COMBINATION STORES. (*See* Meat Retailers.)
COMMERCIAL INVESTMENT TRUST CORPORATION ... 270
COMPETITION. (*See below* References to Literature and Sources, items 40, 97.)
CONFECTIONERY RETAILERS:
Life span:
Poughkeepsie, N. Y., percentage of concerns discontinuing at given age, 1–10 and over years, of 325 established between 1844 and 1926; table 7 ... 13

CONSTRUCTION INDUSTRY:
Births and deaths: Page
Percentage distribution, January–June 1936; table 83 64
Failures:
Mortality percentage of total deaths per failure, Jan. 1936–Sept. 1937; table 82 64
Number of failures and amount of liabilities each year 1938 and 1937, general contractors, carpenters and builders, building subcontractors, other contractors; table 89 68
Numerical distribution, preponderance of small units, general characteristics 253
CONSUMER COOPERATIVES: Movement abroad and in the United States 182–183
CONSUMER CREDIT AGENCIES:
Accounts financing companies, function and operation of 270–272
Commercial Investment Trust Corporation 270
Estimated receivables of all agencies in the United States, at close of each year 1923–37, by major classes of creditors; table 12 291
Loans outstanding 1938: industrial banks, regulated small-loan companies, personal-loan department of banks, credit unions, axias, pawnbrokers; comment and table 20 221
References to literature. (*See* References to Literature and Sources, items 17, 85, 100.)
CONSUMER PREFERENCE: Brand and market 124–125
CONSUMER PROTECTION: Government measures, Federal and State 149–150
CONTRACTORS (*See also* Construction Industry):
Credit loss ratio 129
CONVERSE, PAUL D.: Business Mortality of Illinois Retail Stores from 1925 to 1930; cited (n.) 8, 38, 81, 90
COOPERATIVES: Movement of consumer cooperatives abroad and in the United States 182–183
COPPACK, J. D.: Government Agencies of Consumer Installment Credit; cited (n.) 271
CORPORATE SIZE (*see* Size of Business Enterprise; Small business.)
CORPORATIONS (*see also* Business Organization.)
Crafts. (*See* Crafts.)
Debt; total reported type of debt by total-assets size groups, 1936; table 9 289
Manufacturing corporations. (*See* Manufacturing Concerns.)
Net income; number and percentage of small, intermediate, and large corporations earning net income, by size of total assets, 1932–36; table 14 291
Poughkeepsie, 1844–1927, percentage distribution of life span, all retail concerns and corporations compared, table 51 41
Poughkeepsie, cumulative percentage distribution, 1844–1927, of corporations and all other concerns, by type of business, 1 to 10 years and over; comment and table 79 59–60
Profits; surplus and undivided, less deficits, and combined net profit or loss, by size of total assets, 1936; table 10 290
References to literature. (*See* References to Literature and Sources, item 4.)
Small business. (*See* Small Business.)
COSTS OF OPERATION: Control analysis: Overhead, rent, rent and sales ratios, payroll, payroll and sales ratios, proprietor withdrawals and sales, costs and prices, inventory ratios 105–114
References to literature. (*See* References to Literature and Sources, item 27.)
COTTON TEXTILE MANUFACTURE:
Credit risk:
Comparison of an insolvent and solvent concern, 1922–24, as to asset, liability, sales, inventory and profit ratios, comment and table 120 128

Page

COVER, JOHN H.: Business and personal failure and readjustment in Chicago (1933); cited (n.) and extract 12, 26, 54, 59, 109–110, 120, 130
  Changes in economic welfare (1927); cited (n.) 71
  Changing distribution channels, initiative taken by distributors themselves (1939); cited (n.) and extract 121–122
  Governmental regulation as a factor in business mortality 139–153
  Neighborhood distribution and consumption of meat in Pittsburgh (1932); cited (n.) 85, 116, 120, 124
  Retail price behavior (1935); cited (n.) 122
COWAN, DONALD R. G.: Sales analysis from the management standpoint (1937); (n.) 115, 117, 119, 124
CRAFTS:
  Corporations:
    Poughkeepsie, percentage distribution, 1844–1927, of corporations compared with "all other" organization forms, 1 to 10 years and over; table 79 60
  Life span:
    Poughkeepsie, N. Y., 1315 crafts established between 1844 and 1926: Shoemakers, barbers, tailors, years of life 1–10 and over; percentage distribution; comment and table 16 18–19
    Poughkeepsie, 1844–1926, number established, number and percent distribution lasting 1 to 10 years and over; compared with other types of business; comment and tables 69–70 53–54
    Poughkeepsie, 1844–1926, number of concerns established, number and percent lasting more than 20 years, compared with other types of business; table 71 54
  Organization types:
    Poughkeepsie, percentage distribution of 1,595 concerns by type of organization; table 78 60
  Population per establishment:
    Poughkeepsie, 1842, 1873, 1903, 1933, compared with other types of business; comment and table 72 55
CREAMER, DANIEL T.: Is industry decentralizing? (1935); cited (n.) . 76, 78
CREDIT: Business mortality factor 127–134
  References to literature. (*See* References to Literature and Sources, items 10, 11, 57, 80, 89.)
CREDIT LOSSES 128–133
  Boston bankrupts:
    Bad-debt losses as percent of total credit sales, by business groups; manufacturers, wholesalers, retailers; table 122 130
  Packing houses:
    Chicago, number and amount according to length of service life; comment and table 124 131
    Chicago, number and amount of bad-debt losses 3 branch houses, 5-year period; comment and table 123 130
CREDIT RISKS 127–128
  Comparison of an insolvent and solvent cotton-textile manufacturing concern, 1922–24, as to asset, liability, sales, inventory, and profit ratios; comment and table 120 128
CREDIT UNIONS. (*See* Consumer Credit Agencies.)
CRUM, W. L.: Corporate size and earning power (1939); cited (n.) 215
CUSTOMER CHARACTERISTICS:
  Number of customers, average purchases per customer, size of average order, average rate of turn-over, bad-debt losses, percentage of customers satisfactory—
    According to size of first-month purchases; table 127 132
    By size of store, meat market, and combination store; table 126 . 132
    By type of business; comment and table 125 131
DALLAS, TEX.: Business condition field survey. (*See* Houston, Dallas, and Fort Worth, Tex.)
DANVILLE, ILL.: Plan for industrial development 77
DAVIS, HORACE B.: Business mortality: the shoe manufacturing industry (1939); cited (n.) 46, 92
DEAN, JOEL: Statistical determination of costs, with special reference to marginal costs (1936); cited (n.) 112
DECENTRALIZATION OF INDUSTRY. (*See* Location of Industry.)

Page

DENVER, COLO.: Business condition field survey: multiplicity of small banks, summary of capital and credit needs of 81 concerns, some case studies, concerns financed by manufacturers 328–333

DEPARTMENT OF COMMERCE (*see also* Bureau of Foreign and Domestic Commerce; Census Bureau):
- Survey of reports of credit and capital difficulties subscribed by small manufacturers (1935); cited (n.) 224

DEPARTMENT STORES:
- Mortality:
  - Illinois towns, 255, cumulative percentages of 531 stores in July 1925, gone in successive years 1926–30; tables 10–11 14–15
- Operating expense—sale volume percentage relationship, 1933; comment and chart 6 180–181
- Population per store:
  - Illinois towns, 154, number per 10,000 population in 1925 and 1930, by size of town; table 49 39
- Profits:
  - Percentage of total capital, 1924–28; comment and table 15 186–187
- Sales experience:
  - Amount of total retail sales, amount and percent of department-store sales, estimated respectively by Foreign and Domestic Commerce Bureau and Bureau of the Census, 1929–39; table 10 182
  - Index of value of sales, 1929–40; comment and chart 5 180–181
  - Net operating results: percentage of sales, 1930–37; by size of business groups; table 11 182
- Survival:
  - Enterprises in 32 county-seat towns, general merchandise and department stores, 1915 and 1935; number of survivors, 1935; table 6 12

DEPRESSION PERIODS:
- Effect on mortality rates:
  - Grocery stores, Austin, Tex., during 1884–85, 1896–97, 1906–7, 1913–14, 1921–22, 1928–29; total mortality, percent mortality 1- to 2-year olds of total; comment and table 34 28
  - Grocery stores, Austin, Tex., 1- to 2-year olds, in decline period of depressions of 1892–93, 1896–97, 1906–07, 1913–14, 1921–22, 1928–29; table 32 28

DETROIT, MICH.:
- Business condition field survey: equity and venture capital, credit situation, summary of 67 case studies 318–324
- Tenancy-business property: fluctuations, square feet of rental area changes between October 1, 1938, and May 1, 1939; table 92 70–71

DISTRIBUTION CHANNELS:
- Government regulation of 147
- Problem discussed 121–122
- References to literature. (*See below* References to Literature and Sources, items 19, 90, 91, 92.)

DOUGLAS, WILLIAM O.: Some functional aspects of bankruptcy (1932); cited (n.) 85, 93

DRUG RETAILERS:
- Competition, St. Louis, Mo 123
- Failures:
  - New Jersey: Cost of illness, cause; comment and table 130 135
  - Number of failures, amount of liabilities, each year 1938 and 1937; table 89 68
  - St. Louis, citation 94
- Life expectancy:
  - Buffalo, years 1 to 10, 1920–28; table 53 42
  - Pittsburgh, years 1 to 10, 1925–33, table 52 42
- Life span:
  - Buffalo, N. Y., percentage discontinuing in each successive year, first to ninth, by year of entrance, 1919–27; comment and table 26 24
  - Minneapolis, St. Paul and Duluth; 5-year turn-over ratio and average life in years, 1926–30; table 5 ..... [illegible]

DRUG RETAILERS—Continued.

Mortality: Page

Buffalo, N. Y., 1918–27; percentage withdrawing each year; table 30 ... 27

Colorado towns, cumulative percentages of 13 dealers commencing business in 1927, gone in successive years 1928–35; table 8 ... 13

Colorado towns (142) cumulative percentages of 304 stores in 1926, gone in successive years 1927–35; tables 9, 11 ... 14–15

Illinois towns (255) cumulative percentages of 531 stores in July 1925, gone in successive years 1926–30; tables 10 and 11 ... 14–15

Pittsburgh, Pa., 1925–34, percentage withdrawing each year; table 31 ... 27

Population per store:

Colorado towns (142), number per 1,000 population in 1929 and 1935, by size of town; table 48 ... 39

Illinois towns (154), number per 10,000 population in 1925 and 1930, by size of town; table 49 ... 39

References to literature. (*See below* References to Literature and Sources, item 8.)

Survival:

Enterprises in 32 county seat towns, 1915 and 1935, number of survivors, 1935; table 6 ... 12

DRUG WHOLESALERS:

General line:

Number and percent of establishments, amount and percent of net sales, 1929 and 1935, by size groups (amount of net sales); comment and table 2 ... 169–170

Profits:

Percentage of total capital, 1924–28; comment and table 14 ... 185–186

DRY GOODS RETAILERS:

Mortality:

Colorado towns, cumulative percentages of 13 dealers commencing business in 1927, gone in successive years, 1928–35; table 8 ... 13

Colorado towns (142), cumulative percentages of 168 stores in 1926, gone in successive years 1927–35; tables 9 and 11 ... 14–15

Illinois towns (255), cumulative percentages of 304 stores in July 1925, gone in successive years, 1926–30; tables 10 and 11 ... 14–15

Population per store:

Colorado towns (142), number per 1,000 population in 1929 and 1935, by size of town; table 48 ... 39

Illinois towns (154), number per 10,000 population in 1925 and 1930, by size of town; table 49 ... 39

Profits:

Percentage of total capital, 1924–28; comment and table 15 ... 186–187

Survival:

Enterprises in 32 county seat towns, 1915 and 1935, number of survivors 1935; table 6 ... 12

DRY GOODS WHOLESALERS:

Failures:

Number of failures, amount of liabilities, each year 1938 and 1937; table 89 ... 68

General line:

Number and percent of establishments, amount and percent of net sales, 1929 and 1935; by size groups (amount of net sales); comment and table 3 ... 170–171

Profits:

Percentage of total capital, 1924–28; comment and table 14 ... 185–186

DULUTH, MINN. (*see also* Minneapolis, St. Paul, and Duluth):

Tenancy—business property, fluctuations, square feet of rental area changes between October 1, 1938, and May 1, 1939; table 92 ... 70–71

DUN'S REVIEW: Business births and deaths; issues of February 1937 (Thorp and Rothman), June 1937 (Rothman), March 1938 (Rothman), February 1939 ... 60, 63, 64, 69

ELECTRICAL APPLIANCE RETAILERS:

Life span:

Minneapolis, St. Paul, and Duluth; 5-year turn-over ratio and average life in years, 1926–30; table 5 ... 11

ELECTRICAL APPLIANCE WHOLESALERS:
General line: Page
Number and percent of establishments, amount and percent of net sales, 1929 and 1935; by size groups (amount of net sales); comment and table 5 171–172
Life span:
Minneapolis and St. Paul 51
EMPLOYMENT: Small business contribution to gainful employment; analysis and tables (Nehemkis) 258–259
ENGLE, NATHANAEL H.: Competitive forces in wholesale marketing of prepared food products (1929); cited (n.) 167
The struggle for marketing control 159–188
EPSTEIN, RALPH C.: The automobile industry: its economic and commercial development (1928); cited (n.) 47, 128
Industrial profits in the United States (1934); cited (n.) 186
Profits and size of firms in the auto industry (1931); cited (n.) 90
Rise and fall of firms in the automobile industry (1927); cited (n.) 47, 128
EXPRESS SERVICES:
Life span:
Poughkeepsie, N. Y., established between 1844 and 1926, years of life 1 to 10 and over, percentage distribution; table 17 19
FACTORING: Function and operation of in servicing small business 272–274
Operations of a finance company of major scope 352
Silk industry in Scranton and Wilkes-Barre, Pa 314
FAILURES (*see also* Mortality in Business Population):
Assets—liabilities:
Number of concerns in business, number of failures, amount of assets and of liabilities, average liability, each year, 1915–1937; comment and table 88 67
Banks, Michigan State banks; citation 90
Capital adequacy analysis 87–96
Capital source analysis 91–95
Capital use analysis 95–96
Credit factor 127–134
Cycles of, discussion 71
Defined 5
Drug stores:
New Jersey; cost of illness cause analyzed; comment and table 130 135
St. Louis; citation 94
Fraudulent use of funds 87–88
Grocery stores:
Philadelphia, causes analyzed 92
Lincoln, Nebr., citation 90
Louisville, Ky., citation 93
Insolvency index:
Apparent annual number of failures for each 10,000 of listed commercial enterprises, 1895–1938; comment and table 91 69–70
Investment problems 88
Liabilities (*see also above* Assets—liabilities):
Number of failures, amount of liabilities, each year 1938, 1937, by divisions of industry; table 89 68
Percentage of amounts of total liabilities in particular debt categories—individual proprietors; table 98 93
Manufacturing concerns:
Number of failures as percent of total, by size of liabilities, 1935–39; comment and table 6 212–213
Mortality relationship:
Percentage of total business deaths per failure by major types of industry, January 1936 to September 1937; table 82 64
Piano manufacturing concerns, ratio comparisons, 1926, 1928–29, by types of ratios; comment and table 102 97
References to literature. (*See below* References to Literature and Sources, items 1, 7, 8, 10, 18, 41, 42, 43, 52, 61, 81, 90.)
Retail concerns:
Number of failures as percent of total, by size of liabilities, 1935–39; comment and table 6 212–213

FAILURES—Continued.
Wholesale concerns: Page
Number of failures as percent of total, by size of liabilities, 1935–39; comment and table 6 ... 212–213
FAIR TRADE LAWS. (*See below* References to Literature and Sources, items 55, 68, 95, 101.)
FALL RIVER, MASS.: Field survey of business conditions: consumer income, textile industry, new industries drive, retail business, banks and bank credits, nonbank money lending ... 303–311
FEDERAL CREDIT AGENCIES: Function and operation of Federal Housing Administration, Federal Reserve banks, Reconstruction Finance Corporation ... 269–270
FEDERAL HOUSING ADMINISTRATION: Function and operation of ... 269
FEDERAL RESERVE BANKS:
Applications for industrial advances under section 13b classified according to business and industries, 1934 to 1937; table 20 ... 298
Applications for industrial advances approved under section 13b of the Federal Reserve Act, according to size, 1934 to 1937; table 19 ... 297
Data on loans and advances made under section 13b of the Federal Reserve Act, 1934–39; table 18 ... 296
Loans to small business ... 270
Loans to small business under act of June, 1934 and Regulation "S" ... 231–236
FEDERAL TRADE COMMISSION:
Chain stores: the chain store in the small town (1934); cited (n.) ... 40
Chain stores; size of stores of retail chains (1933); cited (n.) ... 178
Report on resale price maintenance, part 1 (1929); cited (n.) ... 189
FETTER, FRANK A. Competition or monopoly (1938); cited (n.) ... 142
FINANCE. (*See below* References to Literature and Sources, items 46, 51.)
FINANCE COMPANIES: Function and operation of ... 270–272
References to literature. (*See* References to Literature and Sources, items 17, 85, 100.)
Special studies: A medium sized and a company of major scope, analysis of operations ... 347–353
FITZPATRICK, PAUL J.: Comparison of the ratios of successful industrial enterprises with those of failed companies (1932); cited (n.) and extract ... 97
Problem of business failures (1936); cited (n.) ... 95
Symptoms of industrial failures as revealed by analysis of financial statements of failed companies, 1920–29; cited (n.) ... 90, 95, 98
FLOUR MILLING INDUSTRY: Minneapolis to Buffalo, relocation, causes ... 119
References to literature. (*See below* References to Literature and Sources, item 77.)
FOOD MANUFACTURING CONCERNS:
Failures:
Number of failures, amount of liabilities, each year 1938; and 1937; table 89 ... 68
Life span:
Minneapolis, St. Paul, and Duluth, 1926–30 ... 46
Profits:
Percentage of total capital, 1924–28; table 13 ... 186
Ratio of compiled net profit (after tax) to net worth (average equity) average 1931–36, by size of asset class; table 11 ... 215
FOOD RETAILERS:
Failures:
Number of failures, amount of liabilities, each year 1938 and 1937; table 89 ... 68
Life span:
Minneapolis, St. Paul, and Duluth; 5-year turn-over ratio and average life in years (food and vegetables and groceries resp.) 1926–30; table 5 ... 11
FOOD WHOLESALERS:
Life span:
Minneapolis and St. Paul ... 51
References to literature. (*See below* References to Literature and Sources, item 31.)

FOREST PRODUCTS MANUFACTURING CONCERNS:
Failures: Page
Number of failures, amount of liabilities, each year 1938 and 1937; table 89 ---- 68
FORT WAYNE, IND.:
Grocery stores:
Mortality, percent of independent stores closing in 1916–30 and 1890–1904, by number of years in operation, 1 to 9; comment and table 14 ---- 17
Population per store, average number 1915–30 and 1889–1904; comment and table 50 ---- 40
FORT WORTH, TEX.:
Business condition field survey. (*See* Houston, Dallas, and Fort Worth, Tex.)
Tenancy-business property, fluctuations, square feet of rental area changes between October 1, 1938, and May 1, 1939; table 92 ---- 70–71
FOULKE, ROY A.:
Behind the scenes of business (rev. ed. 1939); cited (n.) ---- 66
Financial ratios as guides to operating policies (1938); cited (n.) ---- 112
FOX, LEONARD P.: State taxes and industrial growth; cited (n.) and extract ---- 151–152
FRANCHISES: Factor in business mortality ---- 141
FRANK, JEROME:
Communication to Congressman John W. McCormack (April 1940); cost of flotation of small issues; extracts ---- 264
Proposal for establishment of regional finance companies cited (n.) during testimony on S. 1482 and S. 2343, 76th Congress ---- 278
Regional financing (1940); cited (n.) ---- 278
FRAUD. (*See* Failures.)
FURNITURE RETAILERS: Credit loss ratio ---- 129
Failures:
Number of failures, amount of liabilities, each year 1938 and 1937; table 89 ---- 68
Mortality:
Colorado towns, cumulative percentages of 15 dealers commencing business in 1927, gone in successive years 1928–35; table 8 ---- 13
Colorado towns (142), cumulative percentages of 154 stores in 1926, gone in successive years 1927–35; tables 9 and 11 ---- 14–15
Illinois towns (255), cumulative percentages of 367 dealers in July 1925, gone in successive years 1926–30; tables 10 and 11 ---- 14–15
Population per store:
Colorado towns (142), number per 1,000 population in 1929 and 1935, by size of town; table 48 ---- 39
Illinois towns (154), number per 10,000 population in 1925 and 1930, by size of town; table 49 ---- 39
Profits:
Percentage of total capital, 1924–28; comment and table 15 ---- 186–187
FURST, RUSSELL L.: Relationship between the numbers of chain and individually owned grocery stores in Fort Wayne; cited (n.) ---- 17, 40
GARAGES:
Mortality:
Colorado towns, cumulative percentages of 115 commencing business in 1927, gone in successive years 1928–35; table 8 ---- 13
Colorado towns (142), cumulative percentages of 605 garages in 1926, gone in successive years 1927–35; tables 9, 11 ---- 14–15
Illinois towns (255), cumulative percentages of 1,595 garages in July 1925, gone in successive years 1926–30; tables 10 and 11 ---- 14–15
Population per garage:
Colorado towns (142), number per 1,000 population in 1929 and 1935, by size of town; table 48 ---- 39
Illinois towns (154), number per 10,000 population in 1925 and 1930, by size of town; table 49 ---- 39
GARVER, F. B., *and others:* Location of manufactures in the United States, 1899–1929 (1933); cited (n.) ---- 119

GENERAL MERCHANDISE RETAILERS:
Failures: Page
Number of failures, amount of liabilities, each year 1938 and 1937; table 89 68
Mortality:
Colorado towns, cumulative percentages of 20 commencing business in 1927, gone in successive years 1928–35; table 8 13
Colorado towns (142), cumulative percentages of 302 stores in 1926, gone in successive years 1927–35; tables 9 and 11 14–15
Illinois towns (255), cumulative percentages of 758 stores in July 1925, gone in successive years 1926–30; tables 10 and 11 14–15
Population per store:
Colorado towns (142); number per 1,000 population in 1929 and 1935, by size of town; table 48 39
Illinois towns (154), number per 10,000 population in 1925 and 1930, by size of town; table 49 39
Survival. (*See* Department Stores, Survival.)
GLOSSARY:
Corporation finance turn-over 218
Failure 5
Insolvency 5
Liquidation 5
Loss leader selling 190, 192
Migration of industry 73
Mortality in business 4
Resale price maintenance 189
Survival 4
Turn-over 4
GOODRICH, CARTER, et al.: Migration and economic opportunity (1936); cited (n.) 78
GOVERNMENT AID TO BUSINESS: Inducements to locate in Louisiana, Mississippi, New Jersey 151–152
Problem barely touched by Government or private analysis 150
Small Business. (*See* Small Business.)
Tax exemptions 151–152
GOVERNMENT REGULATION:
Business mortality factor; by John H. Cover 139–153
Marketing devices and practices 146
GRANT: Study of the capital market in post-war Britain (1937); cited (n.) 264
GREAT BRITAIN: Committee on Finance and Industry "Macmillan committee" report (1931); cited (n.) 264
GREEN RIVER, WYO.: Transient vendor ordinance 141
GREENSTEIN, BENJAMIN: Periodogram analysis with special application to business failure in the United States, 1867–1932 (1935); cited (n.) 71
GREER, HOWARD C.:
Business mortality among retail meat stores in Chicago between 1920 and 1933 (1936); cited (n.) 9, 19, 22, 37, 44, 89
Customer turn-over experience of meat packing companies (1933); cited (n.) 116
GRETHER, E. T.: Experience in California with fair-trade legislation, restricting price cutting (1936); cited (n.) 193
Price control under fair-trade legislation (1939); cited (n.) 149
GROCERY RETAILERS:
Credit losses:
Philadelphia and Louisville compared, 1928; credit losses as percentage of credit sales by amounts of total annual sales; comment and table 121 129
Failures:
Lincoln, Nebr., citation 90
Louisville, Ky., citation 93
Philadelphia, causes analyzed 92
Life expectancy:
Austin, Tex., percentage chance of continuing in business a given number of years at given age of business; table 56 43
Austin, Tex., survivals out of 1,368 stores, by number of years, 2 to 35; table 55 43

GROCERY RETAILERS—Continued.

Life expectancy—Continued. Page

Buffalo, years 1 to 10, 1920–28; table 53 42

Pittsburgh, years 1 to 10, 1925–33; table 52 42

Life span:

Buffalo, N. Y., percentage discontinuing in each successive year, first to ninth, by year of entrance, 1919–27; comment and table 25 24, 28

Minneapolis, St. Paul, and Duluth; 5-year turn-over ratio and average life in years 1926–30; table 5 11

Poughkeepsie, N. Y., 1844–1933, Colorado towns, 1927–32, Buffalo, 1919–27; comment and table 2 9

Poughkeepsie, N. Y., percentage of concerns discontinuing at given age, 1 to 10 and over years, of 1,218 established between 1844 and 1926; table 7 13

Mortality:

Austin, Tex., accumulated percentage by year periods 2 to 35 years, between 1880 and 1932; comment and table 13 17

Austin, Tex., 1880–81 to 1931–32, closures during period as percent of stores at beginning of each period; comment and table 29 26

Austin, Tex., 1- to 2-year olds, rate of decrease during decline period of depressions of 1892–93, 1896–97, 1906–7, 1913–14, 1921–22, 1928–29; table 32 28

Austin, Tex., 1- to 2-year olds, rates of increase in depression recovery periods of 1894–95, 1898, 1908–09, 1915–16, 1923–24; table 33 28

Austin, Tex., age 1 to 2 years, rate of infant mortality, 1882–1932: comment and table 20 21

Austin, Tex., total mortality, 1- to 2-year olds mortality, percent latter of total, 1884–85, 1896–97, 1906–07, 1913–14, 1921–22, 1928–29; comment and table 34 28

Austin, Tex., total mortality rate, 1882–1932; rate of 1- to 2-year-old stores; percent of latter to total; table 21 22

Buffalo, N. Y., 1918–27; percentage withdrawing each year; table 30 27

Buffalo, N. Y., 1919–27; comment and table 2 9

Colorado towns, comulative percentages of 128 commencing business in 1927, gone in successive years 1928–35; table 8 13

Colorado towns (142), cumulative percentages of 997 stores in 1926, gone in successive years, 1927–35; tables 9, 11 14–15

Fort Wayne, Ind., percent of independent stores closing in 1916–30 and 1890–1904, by number of years in operation, 1–9; comment and table 14 17

Illinois towns (255), cumulative percentages of 3,646 dealers in July 1925, gone in successive years 1926–30; tables 10–11 14–15

Knoxville, Tenn.; citation 90

Pittsburgh, Pa., 1925–34, percentage withdrawing each year; table 31 27

Poughkeepsie, N. Y., 1844–1933; Hutchinson-Newcomer study; comment and table 2 9

Population per store:

Colorado towns (142), number per 1,000 population in 1929 and 1935, by size of town; table 48 39

Fort Wayne, Ind., average number of persons per store 1915–30 and 1889–1904; comment and table 50 40

Illinois towns (154), number per 10,000 population in 1925 and 1930, by size of town; table 49 39

Present Ownership Date Distribution:

Buffalo; percent distribution of 1,169 independent grocery stores according to present ownership date before 1890 and 1890–1929; comment and table 12 16

Profits:

Percentage of total capital, 1924–28; comment and table 15 186–187

References to literature. (*See below* References to Literature and Sources, items 1, 2, 11, 47, 79, 97.)

GROCERY RETAILERS—Continued.
Sales: Page
Buffalo, dollar amount of independent stores in 1929 according to years of ownership 1890–1929; comment and table 41 33
Buffalo, number of independent stores, percent of total stores, percent of total sales, 1929, 1933, 1935, by amount of sales; comment and table 42 34
Buffalo, sales volume of independent stores in 1933 and 1935, percent of 1929, by size of business in 1929; comment and table 43 35
Survival:
Enterprises in 32 county seat towns, 1915 and 1935, number of survivors 1935; table 6 12
Summary 15–18
Turn-over:
Boston, Mass., turn-over, closing and opening rates for chain-grocery stores, 1929–30; number of stores first of year, number closed in year, number added in year, net change, number stores in business during year, turn-over rate 2 to 5, closing rate 2 to 1, opening rate 3 to 1, average number of stores during year; turn-over 2 to 9; table 15 18
GROCERY WHOLESALERS:
General line:
Number and percent of establishments, amount and percent of net sales, 1929 and 1935, by size groups (amount of net sales); comment and table 1 168–169
Profits:
Percentage of total capital, 1924–28, comment and table 14 185–186
HALLAS, E. T.: Mortality of retail stores in Colorado; cited (n.) 8, 38, 82
HARDWARE RETAILERS:
Life expectancy:
Buffalo, years 1–10, 1920–28; table 53 42
Pittsburgh, years 1–10, 1925–33; table 52 42
Life span:
Buffalo, N. Y., percentage discontinuing in each successive year, 1st–9th, by year of entrance, 1919–27; table 27 25
Minneapolis, St. Paul and Duluth; 5-year turn-over ratio and average life in years, 1926–30; table 5 11
Mortality:
Buffalo, N. Y., 1918–27; table 30 27
Colorado towns, cumulative percentages of 12 commencing business in 1927, gone in successive years 1928–35; table 8 13
Colorado towns (142), cumulative percentages of 188 stores in 1926, gone in successive years 1927–35; tables 9, 11 14–15
Illinois towns (255), cumulative percentages of 442 stores in July 1925, gone in successive years, 1926–30; tables 10–11 14–15
Pittsburgh, Pa., 1925–34, percentage withdrawing each year; table 31 27
Population per store:
Colorado towns (142), number per 1,000 population in 1929 and 1935, by size of town; table 48 39
Illinois towns (154), number per 10,000 population in 1925 and 1930, by size of town; table 49 39
Survival:
Enterprises in 32 county seat towns, 1915 and 1935, number of survivors 1935; table 6 12
HARDWARE WHOLESALERS:
General line:
Number and percent of establishments, amount and percent of net sales, 1929 and 1935; by size groups (amount of net sales); comment and table 4 170–171
Profits:
Percentage of total capital, 1924–28; comment and table 14 185–186
HARDY, CHARLES O. AND VINER, JACOB: Availability of bank credit in the 7th Federal Reserve District (1935); cited (n.) and extracts 222–224, 266
HEILMAN, E. A.: Mortality of business firms in Minneapolis, St. Paul, and Duluth, 1926–30 (1932); cited (n.) 11, 46, 74, 88

Page

HOMES: Rooms used for business purposes; comment and table 94 .. 83–84, 121
HOTELS:
Failures, number of failures, amount of liabilities, each year 1938–1937; table 89 68
HOUSTON, DALLAS, AND FORT WORTH, TEX.:
Business condition field survey: economic basis of the boom, need of new manufacturing, abundance of regional savings, investment of regional savings, limitations upon commercial credits 341–346
HUTCHINSON, R. G., AND NEWCOMER, A. R. AND MABEL:
Study in business mortality (1938); comment and tables 1–4; cited (n.) 8–10, 25, 35, 41, 121
ILLINOIS (*see also* Chicago):
Retail concerns:
Mortality, 255 towns, cumulative percentage of 9,718 dealers in business in July, 1925, gone in successive years 1926–30; comment and tables 10–11 14–15
Mortality, 255 towns, cumulative percentages of dealers in business in July, 1925, gone in July of successive years 1926 to 1930, by size of town; table 37 30
Population per store, 154 towns, number per 10,000 population in 1925 and 1930, by trades and size of town; table 49 39
INDEXES: Financial solvency index proposal (Fitzpatrick) 95
Measure of location of manufacture suggested (Garver, F. B., and others) 119
INDIANA (*see also* Fort Wayne, Indianapolis):
Retail stores, births and deaths, 1929–37 212
INDIANAPOLIS, IND.: Tenancy-business property, fluctuations, square feet of rental area changes between October 1, 1938, and May 1, 1939; table 92 70–71
INDUSTRIAL LOCATION: (*See* Location of Industry.)
INSOLVENCY: Defined 5
Failures. (*See* Failures.)
INSTALLMENT SALES (*see also* Consumer Credit Agencies; Finance Companies):
Credit loss ratio 129
INTERNAL REVENUE BUREAU: Statistics of income 281
INTERSTATE AND INTRASTATE COMMERCE REGULATION:
Factor in business mortality 144–146
References to literature (*see below* References to Literature and Sources, items 67, 87).
INVENTORY: Ratios. (*See* Cost of Operation.)
INVESTMENT BANKING: Financing of small business 263
INVESTMENT COMPANY OR TRUST:
Financing of small business 264–265
Special study of scope of activity of Y Corporation and intermediate-size business 353–356
Turn-over net worth relation, Minneapolis, St. Paul, Duluth, 5-year ratio, 1926–30; table 77 59
IOWA: Personal loans, number, percent of total such loans; table 100 .. 94
IRON AND STEEL MANUFACTURING CONCERNS:
Failures, number of failures, amount of liabilities, each year, 1938 and 1937; table 89 68
JEWELRY RETAILERS:
Life span:
Minneapolis, St. Paul, and Duluth; 5-year turn-over ratio and average life in years, 1926–30; table 5 11
JEWELRY WHOLESALERS:
Life span:
Minneapolis and St. Paul 51
KENTUCKY: Personal loans, number, percent of total such loans; table 100 94
KNOXVILLE, TENN.:
GROCERY STORES, mortality; citation 90
LAUNDRIES: Failures, number of failures, amount of liabilities, each year 1938 and 1937; table 89 68

LEATHER MANUFACTURING CONCERNS:
Life span: Page
Minneapolis, St. Paul, and Duluth, 1926–30 46
LEATHER WHOLESALE CONCERNS:
Life span:
Minneapolis and St. Paul 51
LEGISLATION:
Small business, summary of bills bearing on financing of small business introduced in the Seventy-sixth Congress 364–370
Small business financing proposals discussed 277–279
LICENSE REQUIREMENTS: Factor in business mortality 141
LIFE EXPECTANCY:
Retail concerns 41–44
Buffalo, N. Y., years 1 to 10, 1920–28, by trades; table 53 42
Pittsburgh, Pa.; years 1 to 10, 1925–33, by trades; table 52 42
LIFE SPAN:
All forms of business organization (*see also below* Corporations):
Chain units, corporations retail concerns 40–41
All types of business (*See also below* Crafts, Drug Retailers, Grocery Retailers, etc.):
Minneapolis, St. Paul, and Duluth, manufacturers, wholesalers, retailers, service, respectively, average number of years in business, 1926–30; comment and table 67 52
Poughkeepsie, 1844–1926, number of enterprises established, number and percent lasting more than 20 years; retail, wholesale, manufacturing, craft, and service, respectively; comment and table 71 54
Poughkeepsie, 1844–1926, number of enterprises, percent distribution by 1 to 10 years and over, retail, wholesale, manufacturing, craft, and service, respectively; comment and tables 69–70 53–54
Poughkeepsie, 1844–1927, percent of 10,000 enterprises established, remaining in business 1, 2, and 10 years, respectively 53
Poughkeepsie, 1844–1933; cumulative percentage distribution: retail, wholesale, manufacture 1 to 3 years, in three 30-year periods, 1844–73, 1874–1903, 1904–33; comment and table 73 55–56
Bankruptcy relationship:
Chicago, 1930–31, 709 concerns 54
Chicago, 1,012 concerns, form of organization percentages 59
Corporations:
Poughkeepsie, cumulative percentage distribution, 1844–1927, of life span of corporations compared with all other forms of business, 1 to 10 years and over; comment and table 79 59–60
Poughkeepsie, years of life, all concerns and corporations, 1844–1927; comment and table 51 41
Crafts:
Poughkeepsie, N. Y., years of life 1 to 10 and over, of 1,315 crafts established between 1844 and 1926: shoemakers, barbers, tailors; percentage distribution; comment and table 16 18–19
Drug stores:
Buffalo, N. Y., percentage discontinuing in each successive year, first to ninth, by year of entrance, 1919–27; comment and table 26 24
Grocery stores:
Buffalo, N. Y., percentage discontinuing in each successive year, first to ninth, by year of entrance, 1919–27; comment and table 25 24, 28
Poughkeepsie, N. Y., 1844–1933, Colorado towns, 1927–32, Buffalo, 1919–27; comment and table 2 9
Hardware stores:
Buffalo, N. Y., percentage discontinuing in each successive year, first to ninth, by year of entrance, 1919–27; table 27 25
Manufacturing concerns:
Minneapolis, St. Paul, and Duluth; printing, woodworking, lumber, food, leather, clothing, music, and radio, 1926–30 46
Poughkeepsie, cumulative percent of firms by years of life, 1 to 10 years and over, between 1844 and 1926; comment and table 59 46

LIFE SPAN—Continued.
Manufacturing concerns—Continued. Page
Poughkeepsie, years of life, 1 to 3 and over, cumulative percentage distribution in three periods, 1844–73, 1874–1903, 1904–33; comment and table 60 ... 47
Meat stores:
Chicago, percent of total in each net worth group, percent in business in 1920 continuing more than 5 years, average length of life of stores in business in 1920, by net worth; comment and table 40 ... 32
Chicago, percentage continuing in business over 5 years, by capital-rating groups; comment and table 96 ... 89
Chicago, Ill., percentage discontinuing in each successive year, first to twelfth, by year of entrance, 1921–32; comment and table 24 ... 23
Chicago, Ill., percentage distribution of meat-market and combination stores in 1933, according to number of years in business, 1 to 13 years and over; comment and table 19 ... 20
Net-worth relationship ... 31–33
Minneapolis, St. Paul, and Duluth, 1926–30; comment and table 62 ... 48
Minneapolis, St. Paul, Duluth, average life of firms in each net-worth class, 1926–30; table 75 ... 56
Retail concerns:
Poughkeepsie, N. Y., 1844–1933; Colorado towns, 1927–32; Illinois towns, 1926–30; comment and table 1 ... 8
Poughkeepsie, N. Y., concerns established between 1844 and 1926; grocery, confectionery, meat, and cigar stores; percent discontinuing at given age, 1 to 10 and over years; comment and table 7 ... 12–13
Poughkeepsie, N. Y., in three 30-year periods, 1844–1933, viz, 1844–73, 1874–1903, 1904–33; 1, 2, or 3 years or less, over 3 years; comment and table 28 ... 25
Size of community, summary of studies ... 29–31
Sales and ... 33–36
Service enterprises:
Poughkeepsie, N. Y., enterprises established between 1844 and 1926, years of life 1 to 10 and over percentage distribution: saloons, restaurants, express service; table 17 ... 19
Shoe manufacturing concerns:
Relation to size of community ... 47–48
Size of community relationship:
Retail concerns ... 29–31
Shoe-manufacturing concerns ... 47–48
Wholesale concerns:
Poughkeepsie, 1844–1927, cumulative percent of firms by years of life, 1 to 10 and over; comment and table 65 ... 51
LINCOLN, NEBR.: Grocery-store failures ... 90
LIQUIDATION:
Chicago firms, experience 1930 ... 26
Defined ... 5
Seasonality ... 26
LITIGATION:
Cases:
Albritton v. *City of Winona* (178 S. Miss. 799) ... 152
Dr. Miles Medical Co. v. *Park & Sons Co.* (220 U. S. 373 (1911)) ... 189
Carothers v. *Town of Booneville* (169 Miss. 511) ... 152
Federal Trade Commission v. *Beech-Nut Packing Co.* (257 U. S. 441 (1922)) ... 189
Gueralain, Inc., v. *F. W. Woolworth Co.* (New York Supreme Court (1939)) ... 199
Old Dearborn Distributing Co. v. *Seagram Distillers* (— U. S. — (1936)) ... 198
U. S. v. *General Electric Co.* (272 U. S. 476 (1926)) ... 189
LOCATION OF INDUSTRY ... 118–121
Business migration, discussed ... 73–79
Centripetal migratory movement ... 78

LOCATION OF INDUSTRY—Continued. Page
Community funds providing equity capital and extending credit 262–263
Concentration in cities, durable and semidurable industries; comment and table 93 78
Danville plan 77
Decentralization phases 79
Defined 73
Factor:
Raw materials, markets, power, and fuel, labor costs, transportation, efficient plant size, climate, tax exemption, financial aid, assurance of passive labor conditions by Government agencies 75–77
Fall River, Mass., new industries drive 305–307
Flour milling; citation 119
Glass industry; citation 118
Index measure form suggestion 119
Intercity migration, changes in rental-area tenancy between October 1, 1938, and May 1, 1939; table 92 70–71
Louisiana, tax exemption 151
Meat wholesalers:
Size of headquarters city and its relationship to sales volume, expenses and earnings; comment and table 117 120
Mississippi:
Booneville's attempt to build factory to be leased to private enterprise outlawed (169 Miss. 511) 152
Tax exemption a constitutional provision in 1890 152
Winona constructs municipal factory to be leased to private concern; test case upheld (178 S. Miss. 799) 152
New Jersey, inducements made, 1938 151
Omaha, Nebr., Omaha Industrial Development Co. set up by the local chamber of commerce 327
Pennsylvania, industrial migration from the State 151–152
References to literature. (*See below* References to Literature and Sources, items 3, 15, 24, 38, 48, 49, 66, 70, 71, 72, 77.)
Scranton, Pa., inducements offered by chamber of commerce 316
Southeastern Governors' Conference invitation to industry to locate in Southeastern States 150
Wilkes-Barre, Pa., inducement offered 315
LOSS LEADER SELLING:
Defined and discussed 190, 192
LOUISIANA: Tax exemption on industrial construction, 1936 151
LOUISVILLE, KY.:
Grocery stores:
Credit losses, 1928, as percentage of credit sales by amounts of total annual sales; table 121 129
Failures; citation 93
LOWRY, WILLIAM AND SWARTZ, CHRISTIAN L.: Causes of Philadelphia commercial failures in the last 14 years (1937); cited (n.) 90
LUMBER RETAILERS:
Failures:
Number of failures, amount of liabilities, each year 1938 and 1937; table 89 68
Life span:
Minneapolis, St. Paul, and Duluth; 5-year turn-over ratio and average life in years, 1926–30; table 5 11
LUMBER MANUFACTURING CONCERNS:
Life span:
Minneapolis, St. Paul, and Duluth, 1926–30 46
LUMBER WHOLESALE CONCERNS:
Life span:
Minneapolis and St. Paul 51
LYON, LEVERETT S., *and others;* Government and economic life, volume 1 (1939); cited (n.) 142
MACHINERY MANUFACTURING CONCERNS:
Failures: number of failures, amount of liabilities, each year 1938 and 1937; table 89 68
MAIL-ORDER HOUSES:
Sales experience:
Monthly average, sales amount, 1929–40; comment and chart 7 182–183

"MACMILLAN COMMITTEE." (*See* Great Britain.)
MANUFACTURING CONCERNS:

Page

Birth rate:
- Probable birth rate ranking by types of business, January to June 1936; table 85 65

Births and deaths:
- Percentage distribution, January to June 1936; table 83 64

Contestants for market control 162

Equity:
- Percentage changes in equity ratios, 1932 and 1936, by asset class; comment and table 5 211

Failures:
- Number of failures, and amount of liabilities each year 1938 and 1937, by types of business; table 89 68
- Number of failures as percent of total, by size of liabilities, 1935–39; comment and table 6 212–213

Failure-mortality relation:
- Percentage of total deaths per failure of manufacturing concerns, January 1936 to September 1937; table 82 64

Financing structure, short- and long-term debt, equity 209–210

Life span:
- Minneapolis, St. Paul, Duluth, average number of years in business, 1926–30, compared with other business types; table 67 52
- Minneapolis, St. Paul, and Duluth; printing, woodworking, lumber, food, clothing, leather, music, and radio, 1926–30 46
- Poughkeepsie, years of life, 1 to 3 and over, cumulative percentage distribution in 3 periods, 1844–73, 1874–1903, 1904–33; comment and table 60 47
- Poughkeepsie, cumulative percent of firms by years of life, 1 to 10 years and over, between 1844 and 1926; comment and table 59 46
- Poughkeepsie, 1844–1926, number of concerns established, number and percent lasting more than 20 years, compared with other types of business; table 71 54
- Poughkeepsie, 1844–1926, number established, number and percent distribution lasting 1 to 10 years and over; compared with other types of business; comment and tables 69 and 70 53–54
- Poughkeepsie, cumulative percentage distribution in three 30-year periods, 1844–73, 1874–1903, 1904–33, compared with retail and wholesale; comment and table 73 55–56
- Poughkeepsie, 2,139 concerns, percentage distribution by years of life, 1 to 10 and over, between 1844 and 1926; comment and table 58 45–46
- Net worth relationship 48

Mortality 45–49
- Minneapolis, St. Paul, Duluth, percent firms closing 1926–30, compared with other types of business; comment and table 66 52

Net worth:
- Minneapolis, St. Paul, Duluth, number of firms in each net worth class, 1930; table 74 56
- Minneapolis, St. Paul, Duluth, number in 1930, by net worth; comment and table 61 48
- Minneapolis, St. Paul, and Duluth number closed 1926–30, by net worth; number as percent of total; comment and table 62 48

Organization types:
- Interchange of proprietorships, partnerships, and corporations forms, percentage distribution of 77,000 case records, January to June 1936; table 80 61–62
- Poughkeepsie, percentage distribution of 1,095 concerns by type of organization; table 78 60
- Poughkeepsie, percent distribution 1,095 firms, 1844–1927, by type of organization and length of life; tables 63, 64 49

Population per establishment:
- Poughkeepsie, 1842, 1873, 1903, 1933, compared with other types of business; comment and table 72 55

MANUFACTURING CONCERNS—Continued.

Profits: Page

Percentage of total capital, by selected industries: foods, chemicals, textiles, metals, rubber, 1924–28; comment and table 13 186

Percentage of total capital, 1924–28; analysis and table 12 185

Ratio of compiled net profit (after tax) to net worth (average equity) in three manufacturing industries (food, metals, textiles), average 1931–36, by size of asset class; comment and table 11 215

Ratio of compiled net profit (after tax) to net worth (average equity) by size of asset class; comment and table 10 214–215

Resale price maintenance proponents, manufacturers of branded goods, reasons 191–192

Small business:

Distribution of 250

Ratios by size and kind of trade, analysis 253–255

Turn-over:

Minneapolis, St. Paul, Duluth, percent firms closing and opening 1926–30; compared with other types of business; table 68 52

Turn-over—net worth relation:

Minneapolis, St. Paul, Duluth, 5-year turn-over ratio, 1926–30; table 77 59

Minneapolis, St. Paul, Duluth, number of firms opened and closed, 1926–30; table 76 58

Working capital:

Aggregate volume of working capital in manufacturing industries: all 1926–36, all large, 1926–38, all small, 1926–36, proportion large to total, 1926–36, index (1929=100) large, 1926–38, and small corporations, 1926–36; comment and table 1 208

MANUFACTURING CORPORATIONS:

Current liabilities:

Ratio to total borrowed capital for corporations in all manufacturing, in manufacturing textiles and their products and in trade, 1932 and 1936, by asset class; comment and table 3 209–210

Equity:

Ratio to total assets for all manufacturing corporations, 1932 and 1936, by asset class comment; and table 4 210

Investment in capital assets:

Small, intermediate and large corporations, by size of total assets, 1936; table 8 289

Life span:

Poughkeepsie, percentage distribution, 1844–1927, of corporations compared with "all other" organization forms, 1 to 10 years and over; table 79 60

Sales:

Gross sales (or gross receipts from operations) in all manufacturing corporations submitting balance sheets, 1932 and 1935, by asset size; comment and table 14 217

Turn-over—Sales to assets:

Ratio in manufacturing corporations submitting balance sheets, 1932 and 1935, returns showing net income and those showing no net income, by asset size; comment and table 15 218

Working capital:

Ratios for corporations in all manufacturing combined, in manufacturing textiles and their products and in trade, 1932 and 1936, by asset class; comment and table 2 209

MARKET REFERENCE 124–125

MARKETING CONTROL: Control analysis 115–126

Government regulation of marketing devices and practices 146

Struggle for marketing control; by N. H. Engle 159–188

Wholesalers as contestants for 161–162

MASSACHUSETTS (*see also* Boston):

Commission on Interstate Cooperation, final report (1939); cited (n.) and extract 74

McGARRY, EDMOND D.: Mortality in retail trade (1930); cited (n.) 9, 24, 27, 41, 83

Structure and stability of retail trade in Buffalo, 1929, 1933, 1935, grocery stores (1939); cited (n.); extracts 16, 33, 34–35, 37

Page

McNAIR, M. P.: Marketing and our economic future (1938); cited (n.) 105
MEANS, GARDINER C., *joint author.* (*See* Berle, A. A., Jr.)
MEARS, ELIOT B.: Strategy in industrial location (1937); cited (n.) 118
MEAT RETAILERS:
- Chain and independents compared, customer characteristics; table 128 133
- Life expectancy:
  - Chicago; meat stores and combination stores, independent, 1920–33, percentage of total number continuing for 1 to 5 years; comment and table 57 44
- Life span:
  - Chicago, percent of total in each net worth group, percent in business in 1920 continuing more than 5 years, average length of life of stores in business in 1920, by net worth; comment and table 40 32
  - Chicago, percentage continuing in business over 5 years, by capital-rating groups; comment and table 96 89
  - Chicago, percentage discontinuing in each successive year, first to twelfth, by year of entrance, 1921–32; comment and table 24 23
  - Chicago, percentage distribution of meat markets and combination stores in 1933, according to number of years in business, 1 to 13 years and over; comment and table 19 20
  - Poughkeepsie, N. Y., percentage of concerns discontinuing at given age, 1 to 10 and over years, of 323 established between 1844 and 1926; table 7 13
- Mortality:
  - Chicago, 1 year olds, straight and combination meat markets, discontinuance percent of total entries, 1921–32; comment and table 23 23
  - Colorado towns (142), cumulative percentages of 129 stores in 1926, gone in successive years 1927–35; tables 9 and 11 14–15
  - Colorado towns, cumulative percentages of 30 commencing business in 1927, gone in successive years 1928–35; table 8 13
  - Illinois towns (255), cumulative percentages of 533 dealers in July 1925, gone in successive years, 1926–30; tables 10 and 11 14–15
- Net worth:
  - Chicago, percent of total in each net worth group, percent in business in 1920 continuing more than 5 years, average length of life of stores in business in 1920, by net worth; comment and table 40 32
- Population per store:
  - Chicago, number of retail stores and per 1,000 population; by type of operation, independent, 1920–33, chain store and all retail, 1929–33; comment and table 47 37–38
  - Colorado towns (142), number per 1,000 population in 1929 and 1935, by size of town; table 48 39
  - Illinois towns (154), number per 10,000 population in 1925 and 1930, by size of town; table 49 39
- References to literature. (*See below* References to Literature and Sources, items 21, 53, 84, 88.)
- Sales experience:
  - Pittsburgh; citation 116
- Turn-over:
  - Chicago, number of entrances, total number in business in year, number of closures, number at end of year, net change, percent to total entrances and closures, year ending July 1, 1920–33, and average for period; comment and table 22 22
  - Chicago, rate of turn-over of meat markets and combination stores, resp., 1921–33; comment and table 18 19–20

MEAT WHOLESALERS:
- Life span:
  - Minneapolis and St. Paul 51
- Location:
  - Size of headquarters city and its relationship to sales volume, expenses, and earnings; comment and table 117 120
- Sales experience:
  - Weekly sales to retailers, meat, grocer, combination, delicatessen, variations in amounts; table 112 116

Page

MELDER, EUGENE F.: State trade walls (1939); cited (n.) 145

MEMPHIS, TENN.:
- Tenancy-business property, fluctuations, square feet of rental area changes between October 1, 1938, and May 1, 1939; table 92 70–71

MEN'S WEAR STORES:
- Survival:
  - Enterprises in 32 county seat towns, 1915 and 1935, number of survivors 1935; table 6 12

MERRELL AND KITTELLE: Analysis of the State fair trade laws (1937); cited (n.) 198

MESSEROLE, WILLIAM H.: Small-scale retailing (1938); cited (n.) 34, 247

METAL MANUFACTURING CONCERNS:
- Profits:
  - Percentage of total capital, 1924–28; table 13 186
  - Ratio of compiled net profit (after tax) to net worth (average equity), average 1931–36, by size of asset class; table 11 215

METROPOLITAN LIFE INSURANCE CO. Policyholders Service Bureau:
- The glass industry; plant location factors 1934–35; cited (n.) 76, 118
- The paint industry; plant location factors (1936); cited (n.) 75

MIGRATION OF INDUSTRY. (*See* Location of Industry.)

MILLER-TYDINGS ACT (1937): Summary 197–198

MILWAUKEE, WIS.:
- Tenancy-business property, fluctuations, square feet of rental area changes between October 1, 1938, and May 1, 1939; table 92 70–71

MINING AND QUARRYING CONCERNS: Small business ratio analysis (Nehemkis) 255

MINNEAPOLIS, MINN.:
- Milling city rank yielded to Buffalo in 1930 119
- Tenancy-business property, fluctuations, square feet of rental area changes between October 1, 1938, and May 1, 1939; table 92 70–71

MINNEAPOLIS, ST. PAUL, AND DULUTH, MINN.:
- All types of business:
  - Life span, manufacturers, wholesalers, retailers, service, respectively, average number of years in business, 1926–30; comment and table 67 52
  - Life span-net worth relationship, average life of firms in each net worth class, 1926–30; table 75 56
  - Mortality; manufacturers, wholesalers, retailers, respectively, percent of firms closing 1926–30; comment and table 66 52
  - Net worth relationship, number of firms in each type by net worth, 1930; comment and table 74 56
  - Turn-over, manufacturing, wholesale, retail, service, percent of firms closing and opening, 1926–30; comment and table 68 52
  - Turn-over-net worth relationship, number of firms opened and closed by type and net worth, 1926–30; comment and table 76 56–58
  - Net worth relationship, 5-year turn-over ratios, 1926–30, by type of business and net worth; comment and table 77 59
- Manufacturing concerns:
  - Life span: printing, woodworking, lumber, food, clothing, leather, music, and radio, 1926–30 46
  - Net worth, number in 1930 by net worth; number and percent closed 1926–30, by net worth; comment and tables 61–62 48
  - Number in 1930, by net worth; comment and table 61 48
- Retail concerns:
  - Life span, by kind of business; 1926–30; comment and table 5 11
  - Net worth, number of retailers in business in 1930 in 3 cities, percent closing 1930, number closing 1926–30, by net worth; comment and table 39 32
  - Net worth, number and percent of retail firms in 3 cities, and percent of all business firms in given net worth group; comment and table 38 31
- Wholesale concerns:
  - Life span, printing and paper, electrical equipment, leather, agricultural machinery, meat, jewelers, food, lumber, music, and radio, clothing 51

MISSISSIPPI: Encouragement to industry by direct physical assistance 152

Page

MITCHELL, W. N.: Trends in industrial location in the Chicago region since 1920 (1933); cited (n.) 73
MONOPOLISTIC PRACTICES: Factor in business mortality 141–143
MORTALITY IN BUSINESS POPULATION (*see also* Failures):
Credit factor 127–134
Defined 4
Franchises a factor 141
Government Regulation As a Factor; by John H. Cover 139–153
Grocery stores. (*See* Grocery Retailers.)
Interstate and intrastate commerce regulation as a factor 144–146
License requirements as a factor 141
Manufacturing concerns. (*See* Manufacturing Concerns.)
Meat stores. (*See* Meat Retailers.)
Percentage distribution:
Births and deaths, percentage distribution, January–June, 1936, by industrial divisions; comment and table 83 64
Minneapolis, St. Paul, and Duluth manufacturers, wholesalers, retailers, respectively; percent of firms closing 1926–30; comment and table 66 52
Total business deaths per failure by major types of industry, January 1936–September, 1937; table 82 64
References to literature. (*See below* References to Literature and Sources, items 2, 6, 30, 53, 56, 58, 59, 63, 79, 82.)
Retailers. (*See* Retail Concerns.)
Standardization a factor 141
Types of Business:
Minneapolis, St. Paul, Duluth, percent each type closing 1926–30; comment and table 66 52
Zoning restrictions a factor 141
MURCHISON, CLAUDIUS: Relocation of the Cotton Textile Plant (1932); cited (n.) 74
MUSIC AND RADIO CONCERNS:
Life span: Minneapolis, St. Paul, and Duluth, 1926–30 46, 51
NATIONAL ASSOCIATION OF RETAIL DRUGGISTS: Model draft resale price-maintenance law, reference to 198
NATIONAL RECOVERY ADMINISTRATION: Report of the President's Committee of Industrial Analysis (1937); cited (n.) 141
NATIONALITY AND RACE FACTOR:
Congestion of retail stores influenced by 120–121
Credit agencies. (*See* Axias.)
NEBRASKA: (*See* Omaha.)
NEHEMKIS, PETER R., Jr.: The Financial Problem of Small Business 245–279
NET WORTH:
All business types:
Minneapolis, St. Paul, and Duluth, 1930; comment and table 74 56
Life span relationship 31–33
Manufacturing concerns 48
Minneapolis, St. Paul, Duluth, average life of firms in each net worth class, 1926–30; table 75 56
Meat stores. (*See* Meat Retailers.)
Retail concerns. (*See* Retail Concerns.)
Turn-over relationship:
Minneapolis, St. Paul, Duluth, number of firms opened and closed by type and net worth, 1926–30; comment and table 76 56–58
Minneapolis, St. Paul, Duluth, 5-year turn-over ratios, by type of business and net worth, 1926–30; comment and table 77 59
NEW JERSEY. (*See also* Paterson):
Inducements to industry to migrate into State, 1938 151
Capital source, Boston and New Jersey compared, original capital, by sources, percentages of total; comment and table 99 93–94
Bankruptcies:
Accounting records of firms by type of business, compared with Boston firms; table 95 86
NEW YORK STATE. (*See* Buffalo, Poughkeepsie.)
NEWCOMER, A. R. AND MABEL, *joint authors.* (*See* Hutchinson, R. G.)
NICHOLSON, J. L.: Fallacy of easy money for small business (1938); cited (n.) 219

NIXON, A. J., *joint author.* (*See* Garver, F. B., and others.)
NOVELTY RETAILERS: Page
Life span; Minneapolis, St. Paul and Duluth; 5-year turn-over ratio and average life in years, 1926–30; table 5 ... 11
NUGENT, ROLF:
Consumer credit and economic stability (1939); cited (n.) ... 270
Estimate of loans outstanding, 1938, by consumer credit agencies ... 221
NYSTROM, PAUL H.:
Chain stores, opinion on future of ... 176
Economics of retailing (1919); cited (n.) and extract ... 82
Opportunities for the improvement of retail management (1936); cited (n.) ... 82
OFFICE EQUIPMENT RETAILERS: Life span, Minneapolis, St. Paul, and Duluth; 5-year turn-over ratio and average life in years, 1926–30; table 5 ... 11
OMAHA, NEBR.: Business condition field survey: manufacturing, cash basis in enterprise, commercial banking situation, problem of succession in small proprietary enterprise, Omaha's community business fund ... 324–328
Tenancy—business property, fluctuations, square feet of rental area changes between October 1, 1938, and May 1, 1939; table 92 ... 70–71
OREGON. (*See* Portland.)
ORGANIZATION FARMS. (*See* Business Organization.)
OVERHEAD COSTS. (*See* Costs of Operation.)
PACKING HOUSES:
Credit losses:
Chicago, number and amount according to length of service; comment and table 124 ... 131
Chicago, number and amount of bad-debt losses three branch houses, 5-year period; comment and table 123 ... 130
Sales experience:
Customer mortality, percentage lost and rate of customer turnover; table 114 ... 117
Number of customers served, number of orders sold, total dollar sales, number of orders per month, dollar sales per month, per order, three branch packing houses, 1926–30; table 113 ... 116
PAPER AND PRINTING WHOLESALERS: Life span, Minneapolis and St. Paul ... 51
PAPER, PRINTING, PUBLISHING MANUFACTURING CONCERNS: Failures, number of failures, amount of liabilities, each year 1938 and 1937; table 89 ... 68
PARLOR STORES. (*See* Homes.)
PARTNERSHIPS. (*See* Business Organization.)
PATERSON, N. J.: Silk industry, financing of small units analysis and table 92 ... 91–92
PAWNBROKERS. (*See* Consumer Credit Agencies.)
PENNSYLVANIA (*see also* Philadelphia, Pittsburgh, Scranton, and Wilkes-Barre):
Industrial emigration from Pennsylvania ... 151–152
Personal loans:
Business borrowers from personal finance companies, by occupation, number and percent of loans; table 101 ... 95
Number, percent of total such loans; table 100 ... 94
PERSONAL LOANS:
Number:
Pennsylvania, number and percent of loans by business borrowers, by occupation; table 101 ... 95
Percent number of loans in Iowa, Kentucky, Pennsylvania, and Wisconsin of total loans; comment and table 100 ... 94
PHILADELPHIA, PA.:
Bankruptcy records; citation ... 90
Grocery stores:
Credit losses, 1928, as percentage of credit sales by amounts of total annual sales; table 121 ... 129
Failures, causes analyzed ... 92
Tenancy—business property, fluctuations, square feet of rental area changed between October 1, 1938, and May 1, 1939; table 92 ... 70–71
PHILLIPS, CHARLES F.: Chain store mortality (1934); cited (n.) ... 17

Page

PICKETT, VICTOR G., AND VAILE, ROLAND S.: Decline of Northwestern flour milling (1933); cited (n.) 119

PITTSBURGH, PA.:
- Kosher markets 116, 124
- Meat retailers, sales experience; citation 116
- Retail concerns:
  - Life expectancy, years 1 to 10, 1925–33, by trades; table 52 42
  - Mortality, 1925–34; hardware, shoe, drug, and grocery stores, percentage with drawing of total number in business each year; table 31 27

POPULATION PER STORE:
- Austin, Tex.:
  - Number of stores, number of persons per store, 1879–97 every odd year, 1898, 1900, 1903–9 every odd year, 1912–24 every even year, 1927, 1929–30, 1932; comment and table 46 37
- Buffalo, N. Y.: Comment 37
- Chicago:
  - Meat stores, number retail stores by type of operation; independent, 1920–33, chain-store, all retail, 1929–33. Total number and per 1,000 population; comment and table 47 37–38
- Colorado towns (142):
  - Number per 1,000 population in 1929 and 1935, by size of towns and by trades; comment and table 48 39
- Fort Wayne, Ind.:
  - Grocery stores, average number of persons per store 1915–30 and 1889–1904; comment and table 50 40
- Illinois towns (154):
  - Number per 10,000 population in 1925 and 1930, by trades and size of town; table 49 39
- Poughkeepsie, N. Y.: Comment 36
- Poughkeepsie, 1842, 1873, 1903, 1933; retail, wholesale, manufacture, craft, service; comment and table 72 55

PORTLAND, OREG.: Business condition field survey. (*See* Seattle, Wash. and Portland, Oreg.)
- Tenancy-business property: Fluctuations, square feet of rental area changed between October 1, 1938, and May 1, 1939; table 92 70–71

POUGHKEEPSIE, N. Y.:
- All types of business:
  - Life span, 1844–1926, number of enterprises established, number and percent lasting more than 20 years; retail, wholesale, manufacturing, craft, and service, respectively; comment and table 71 54
  - Life span, 1844–1933; cumulative percent distribution; retail, wholesale, manufacture 1 to 3 years, in three 30-year periods, 1844–73, 1874–1903, 1904–33; comment and table 73 55–56
- All types of business organization:
  - Business type relationship, percent each type of organization of 12,618 firms, by type of business; comment and table 78 59–60
  - Life span, 1844–1926, number of enterprises established, percent distribution by 1 to 10 years and over, retail, wholesale, manufacturing, craft, and service, respectively; comment and tables 69 and 70 53–54
  - Survival experience, 1844–1927, percent, respectively, retail, service, manufacturing, and wholesale 53
- Confectionery stores: (*See* Confectionery Retailers.)
- Corporations:
  - Life span, percentage distribution, 1844–1927, of corporations and "all other" organization forms compared, 1 to 10 years and over; table 79 60
- Crafts:
  - Life span of 1,315 crafts established between 1844 and 1926: Shoemakers, barbers, tailors, years of life 1 to 10 and over; percentage distribution; comment and table 16 18–19
- Grocery stores: (*See* Grocery Retailers.)

POUGHKEEPSIE, N. Y.—Continued.

Manufacturing concerns: Page

Life span relation to form of organization, percent distribution 1,095 firms, 1844–1927, by type of organization and length of life; tables 63 and 64 — 49

Life span, years of life, 1 to 3 and over, cumulative distribution in 3 periods, 1844–73, 1874–1903, 1904–33; comment and table 60 — 47

Life span, 2,139 concerns, percentage distribution by years of life, 1 to 10 and over, between 1844 and 1926; comment and table 58 — 45–46

Life span, cumulative percent of firms by years of life, 1 to 10 years and over, between 1844 and 1926; comment and table 59 — 46

Meat stores: (*See* Meat Retailers.)

Population per store:

Population per business establishment, 1842, 1873, 1903, 1933; retail, wholesale, manufacture, craft, service; comment and table 72 — 55

Restaurants: (*See* Restaurants.)

Retail concerns:

Homes or in separate buildings, total number of concerns, percent distribution by location, 1873–76, 1923–26, by type of business; comment and table 94 — 83–84, 121

Life span, all concerns and corporations, 1844–1927; comment and table 51 — 41

Life span, all concerns 1 to 5 years, 1844–1933; comment and table 1 — 8

Life span; in three 30-year periods, 1844–1933, viz 1844–1873, 1874–1903, 1904–33; 1, 2, or 3 years or less, over 3 years; comment and table 28 — 25

Service enterprises:

Life span, enterprises established between 1844 and 1926, years of life 1–10 and over percentage distribution: Saloons, restaurants, express service; table 17 — 19

Wholesale concerns:

Life span, 1844–1927, cumulative percent of firms by years of life, 1 to 10 and over; comment and table 65 — 51

PRICES:

Buying and selling price — 109

Control: *See* Resale Price Maintenance.

Policies and practices; Government regulation of — 148

References to literature. (*See below* References to literature and Sources, items 5, 12, 22, 39, 55, 68, 95, 96, 101.)

PRINTING CONCERNS (*See also* Paper and Printing Wholesalers, Paper Printing and Publishing Manufacturing Concerns):

Life span, Minneapolis, St. Paul, and Duluth, 1926–30 — 46

PRODUCTS:

Control analysis — 124–126

Proportions of different products sold to small and large buyers by 4 wholesalers; comment and table 118 — 124

Relationship of product expense to volume per item and per interview, 15 wholesalers, in percentages of average; comment and table 119 — 125

PROFIT:

All corporations:

Ratio of compiled net profit (after tax) to net worth (average equity), average 1931–36, by size of asset class; comment and table 12 — 216

Manufacturing, wholesaling, retailing, discussion — 184–187

Manufacturing concerns:

Ratio of compiled net profit (after tax) to net worth (average equity) by size of asset class; comment and table 10 — 214–215

Ratio of compiled net profit (after tax) to net worth (average equity) in three manufacturing industries (food, metals, textiles), average 1931–36, by size of asset class; comment and table 11 — 215

References to literature. (*See below* References to Literature and Sources, items 33, 34.)

Page
PROHIBITORY REGULATION: Factor in business mortality 141
PROPRIETORSHIPS: (*See* Business Organization.)
RACE and NATIONALITY FACTOR: Congestion of retail stores influenced by 120–121
RACIAL GROUPS: Credit agencies. *See* Axias.
RADIO STORES:
Life span, music and radio concerns, Minneapolis, St. Paul and Duluth, 1926–30 46, 51
Retail, credit loss ratio 129
REBORI, JOHN N.; Business mortality of grocery stores in Knoxville, Tenn. (1937); cited (n.) 90
RECONSTRUCTION FINANCE CORPORATION: Business enterprises to which loans were authorized, and amounts authorized and disbursed as of Feb. 29, 1940, by industries; table 24 301–302
Business loans authorized number and amount by size of loans, as of Feb. 29, 1940; table 22 300
Business loans authorized, amount by years, 1934–39; table 21 299
Business loans disbursed number and amount by size of loans, as of Feb. 29, 1940; table 23 300
Function and operation of 270
Loans to small business under acts of June 1934 and April 1938 228–231, 234–236
RECOVERY PERIODS:
Effect on mortality rates, grocery stores, 1 to 2 year olds, Austin, Tex., in depression recovery periods of 1894–95, 1898, 1908–9, 1915–16, 1923–24; table 33 28
REFERENCES TO LITERATURE AND SOURCES.
1. Avery, Harold S. Some aspects of grocery store failure (1926); cited (n.) 90
2. Ayers, Solon. A study of mortality of retail grocery stores in Austin, Tex., from 1880 to 1932; cited (n.) 7, 17, 26, 37, 71, 115
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11. Bureau of Foreign and Domestic Commerce. Trade Information Bulletin No. 700. Credit extension and causes of failure among Philadelphia grocers; cited (n.) 92
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14. Census Bureau. Census of manufactures for 1937 281
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17. Coppack, J. D. Government agencies of consumer installment credit; cited (n.) 271
18. Cover, John H. Business and personal failure and readjustment in Chicago (1933); cited (n.) and extract 12, 26, 54, 59, 109–110, 120, 130

REFERENCES TO LITERATURE AND SOURCES—Continued. Page

19. Cover, John H. Changing distribution channels; initiative taken by distributors themselves (1939); cited (n.) and extract ---- 121–122
20. Cover, John H. Changes in economic welfare (1927); cited (n.) - 71
21. Cover, John H. Neighborhood distribution and consumption of meat in Pittsburgh (1932); cited (n.) ---- 85, 116, 120, 124
22. Cover, John H. Retail price behavior (1935); cited (n.) ---- 122
23. Cowan, Donald R. G. Sales analysis from the management standpoint (1937); cited (n.) ---- 115, 117, 119, 124
24. Creamer, Daniel T. Is industry decentralizing? (1935); cited (n.) - 76, 78
25. Crum, W. L. Corporate size and earning power (1939); cited (n.) ---- 215
26. Davis, Horace B. Business mortality; the shoe manufacturing industry (1939); cited (n.) ---- 46, 92
27. Dean, Joel. Statistical determination of costs, with special reference to marginal costs (1936); cited (n.) ---- 112
28. Department of Commerce, Survey of reports of credit and capital difficulties subscribed by small manufacturers (1935); cited (n.) ---- 224
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32. Epstein, Ralph C. The automobile industry: its economic and commercial development (1928); cited (n.) ---- 47, 128
33. Epstein, Ralph C. Industrial profits in the United States (1934); cited (n.) ---- 185
34. Epstein, Ralph C. Profits and size of firms in the auto industry (1931); cited (n.) ---- 90
35. Epstein, Ralph C. Rise and fall of firms in the automobile industry (1927); cited (n.) ---- 47, 128
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37. Federal Trade Commission. Chain stores; size of stores of retail chains (1933); cited (n.) ---- 178
38. Fox, Leonard P. State taxes and industrial growth; cited (n.) and extract ---- 151–52
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40. Fetter, Frank A. Competition or monopoly (1938); cited (n.) ---- 142
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42. Fitzpatrick, Paul J. Problem of business failures (1936); cited (n.) ---- 95
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REFERENCES TO LITERATURE AND SOURCES—Continued. Page

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75. Nystrom, Paul H. Opportunities for the improvement of retail management (1936); cited (n.) 82
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REFERENCES TO LITERATURE AND SOURCES—Continued. Page

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86. Social Security Board. Old-age and survivors insurance; tables compiled in 1939 281
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91. Thorp, Willard L. Changing distribution channels (1939); cited (n.) and extract 121, 160, 178
92. Thorp, Willard L. Changing structure of industry (1929); cited (n.) 79, 118
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101. Zorn and Feldman. Business under the new price laws (1937); cited (n.) 198

RENT: Accounting. (*See* Costs of Operation.)

RENTAL SPACE. (*See* Tenancy.)

RESALE PRICE MAINTENANCE:
- Definition 189
- Economic and social reasons for 192–193
- Economic summary, by Dr. Earl D. Strong 189–203
- Interrelationships with other factors that reduce price competition and with outside fields 202–203
- Laws:
  - California. Fair Trade Law, 1931 as amended 1933; text and analysis 196–198
  - Federal, Miller-Tydings Act, 1937; summary 197–198
  - States which have enacted resale-price-maintenance laws 198
- Litigation:
  - *Old Dearborn Distributing Co.* v. *Seagram Distillers*, United States (1936) 198
- National Association of Retail Druggists, model draft law, reference to 198
- Opponents' arguments 193–196
- Practice of, difficulties and limitations 199–202
- Proponents' arguments, wholesalers, manufacturers of branded goods 189–192

RESTAURANTS:
- Failures:
  - Number of failures, amount of liabilities, each year 1938 and 1937; table 89 68
- Life span:
  - Poughkeepsie, N. Y., established between 1844 and 1926, years of life 1–10 and over percentage distribution; table 17 19
  - Poughkeepsie, N. Y., 1844–1926; Colorado towns, 1927–35; comment and table 4 10

RESTAURANTS—Continued. Page
Mortality:
Colorado towns, cumulative percentages of 170 commencing business in 1927, gone in successive years 1928–35; table 8 ---- 13
Colorado towns (142), cumulative percentages of 501 restaurants in 1926, gone in successive years, 1927–35; tables 9, 11 ------ 14–15
Illinois towns (255), cumulative percentages of 978 restaurants in July, 1925, gone in successive years, 1926–30; tables 10–11 - 14–15
Population per restaurant:
Colorado towns (142), number per 1,000 population in 1929 and 1935, by size of town; table 48 ---- 39
Illinois towns (154), number per 10,000 population in 1925 and 1930, by size of town; table 49 ---- 39
RESTRAINTS OF TRADE: Factor in business mortality ---- 141–143
RETAILERS:
All concerns:
Index of rural sales of general merchandise, passenger automobile sales, lumber, building, hardware, variety store sales, department store sales, jewelry store sales, apparel group sales, drug store sales, 1929–38; comment, chart 3 and table 8 - 176–178
Number of stores, amount of sales, average sales per store, population per store, sales per capita, expense as percent of sales, proprietors, employees, average number per store, sales per employee, 1929, 1933, 1935; comment and table 6 ------ 173–174
Birth rate:
Probable birth rate ranking by types of business, January to June 1936; table 85 ---- 65
Births and deaths:
Indiana, 1929–37 ---- 212
Percentage distribution, January to June 1936; table 83 ---- 64
Contestants for market control ---- 162
Corporations:
Poughkeepsie, percentage distribution 1844–1927, of corporations and all other organization forms compared, 1 to 10 years and over; table 79 ---- 60
Failure-mortality relationship:
Percentage of total deaths per failure of retailing concerns, January 1936 to September 1937; table 82 ---- 64
Failures:
Number of failures and amount of liabilities, each year 1938 and 1937, by types of business; table 89 ---- 68
Number of failures as percent of total, by size of liabilities, 1935–39; comment and table 6 ---- 212–213
General-store versus specialization trends ---- 183–184
Homes versus separate buildings:
Poughkeepsie, total number of concerns, percent in homes, percent in separate buildings, 1873–76 and 1923–26, by type of business; comment and table 94 ---- 83–84, 121
Independent and chain:
Number and percent, percent of total sales, by gross sales classes, 1935; table 13 ---- 217
Independent merchant, position of ---- 183
Life expectancy ---- 41–44
Life span:
Minneapolis, St. Paul, Duluth, average number of years in business, 1926–30; compared with other business types; table 67 --- 52
Minneapolis, St. Paul, and Duluth, 1926–30, by trade; comment and table 5 ---- 11
Poughkeepsie, all concerns and corporations, 1844–1927, compared; comment and table 51 ---- 41
Poughkeepsie, cumulative percentage distribution in three 30-year periods, 1844–73, 1874–1903, 1904–33, compared with manufacturing and wholesale; comment and table 73 ---- 55–56
Poughkeepsie, N. Y., concerns established between 1844 and 1926; grocery, confectionery, meat, and cigar stores; percent discontinuing at given age, 1–10 and over years; comment and table 7 - 12–13

RETAILERS—Continued.
Life span—Continued. Page
Poughkeepsie, N. Y., in three 30-year periods, 1844–1933, viz, 1844–73, 1874–1903, 1904–33; 1, 2, or 3 years or less, over 3 years; comment and table 28 25
Poughkeepsie, N. Y., 1844–1933; Colorado towns, 1927–32; Illinois towns, 1926–30; comment and table 1 8
Poughkeepsie, 1844–1926, number established, percent distribution by 1 to 10 years and over; compared with other types of business; comment and tables 69–70 53–54
Poughkeepsie, 1844–1926, number of concerns established, number and percent lasting more than 20 years, compared with other types of business; table 71 54
Size of community summary of studies 29–31
Mortality:
Buffalo, 1918–27: Grocery, drug, hardware, and shoe stores, percentage going out of business of total number in business each year; table 30 27
Causes: managerial inadequacy, lack of training, inexperience, age, personality, accounting records 81–86
Colorado (1926) and Illinois (1925) compared; cumulative percentages of dealers in business in base years, gone in successive years, 1–5; comment and table 11 15
Colorado towns (142), cumulative percentages of 3587 dealers in business in 1926, gone in successive years 1927–35, by trade; comment and table 9 14
Colorado towns (142), cumulative percentage of dealers in business in 1926, gone in successive years 1927–35, by size of town; comment and table 36 30
Colorado towns (142), cumulative percentages of dealers commencing business in 1927, gone in successive years, 1928–35; comment and table 8 13
Illinois towns (255), cumulative percentages of dealers in business in July 1925, gone in July of successive years 1926 to 1930, by size of town; table 37 30
Illinois towns (255), cumulative percentage of 9,718 dealers in business July 1925, gone in successive years, 1926–30; comment and tables 10–11 14–15
Minneapolis, St. Paul, Duluth, percent firms closing 1926–30, compared with other types of business; comment and table 66 52
Minnesota cities, three, number of retailers in business in 1930, percent closing 1930, number closing 1926–30, by net worth; comment and table 39 32
Pittsburgh, Pa., 1925–34: Hardware, shoe, drug, and grocery stores, percentage withdrawing of total number of stores in business each year; table 31 27
Poughkeepsie, N. Y., 1844–1932. Hutchinson and Newcomer study (1938); comment and tables 1–4 8–10
Net worth:
Minnesota cities, three, number and percent retail firms and percent of all business firms in given net worth group; comment and table 38 31
Minneapolis, St. Paul, Duluth, number of firms in each net worth class, 1930; table 74 56
Minnesota cities, three, number of retailers in business in 1930, percent closing 1930, number closing 1926–30 by net worth; comment and table 39 32
Organization types:
Interchange of proprietorships, partnerships and corporations, percentage distribution, January to June, 1936; table 80 61–62
Poughkeepsie, percentage distribution of 6,230 by type of organization; table 78 60
Population per establishment:
Poughkeepsie, 1842, 1873, 1903, 1933, compared with other types of business; comment and table 72 55

RETAILERS—Continued.
Page
Profits:
Percentage of total capital, 1924–28; analysis and table 12 ... 185
Percentage of total capital, selected trades; grocery, dry goods, department stores, furniture, building materials and hardware, 1924–28; comment and table 15 ... 186–187
References to literature. *See above* References to literature and sources, items 6, 16, 56, 63, 64, 69, 74, 75, 83, 98.
Sales experience:
Percentage distribution of stores and average sales per store, by size of stores, 1929, 1933, 1935; comment, table 7 and chart 2 ... 173–175
Trend analysis, 1929–30, percent of 1929 volume; comment and chart 1 ... 172–173
Size of establishments:
Trend analysis, 1929–35; charts 1–2 and tables 6–7 ... 172–176
Specialization versus general store trends ... 183–184
Survival:
Enterprises in 32 county seat towns, by trade, 1915 and 1935; number of survivors; comment and table 6 ... 12
In 32 county seat towns, 1915 and 1935; comment and table 6 ... 12
Turnover:
Minneapolis, St. Paul, Duluth, percent firms closing and opening 1926–30; compared with other types of business; table 68 ... 52
Number of new, discontinuing, succession concerns and net gain, 1936 to September 1937, in quarterly periods; comment and table 81 ... 63
Turnover-net worth relationship:
Minneapolis, St. Paul, Duluth, 5-year ratio, 1926–30, table 77 ... 59
Minneapolis, St. Paul, Duluth, number of firms opened and closed, 1926–30; table 76 ... 58
RIEFLER, WINFIELD W.: Medium term credit in the United States, unpublished report; cited (n.) ... 265
ROBINSON-PATMAN ACT: Relation to resale price maintenance laws ... 202
RODKEY, ROBERT G.: State bank failures in Michigan (1935); cited (n) ... 90, 129
ROTHMAN, WILLIAM A.: Business births and deaths (1937, 1938); cited (n.) ... 60, 63, 129
RUBBER MANUFACTURING CONCERNS:
Profits: Percentage of total capital, 1924–28; table 13 ... 186
RYAN, FRANKLIN W.: Municipal control of retail trade in the United States; cited (n.) ... 130, 140
ST. LOUIS, MO.: Drug stores, competition ... 123
Grocery stores, failures; citation ... 74
Tenancy—business property, fluctuations, square feet of rental area changes between Oct. 1, 1938, and May 1, 1939; table 92 ... 70, 71
ST. PAUL, MINN. (*See* Minneapolis, St. Paul, and Duluth.)
SALES: Control analysis ... 115–126
SALES EXPERIENCE:
Chain stores:
Number of chain stores and full-year sales, by size of store; comment and table 9 ... 178
Percent of total; grocery and combination stores, chain drug stores, all kinds of business; comment and chart 4 ... 176–177
Consumer preference, brand and market ... 124–125
Cost of selling analysis ... 117–118
Credit losses ... 128–133
Customer characteristics:
According to size of store; table 126 ... 132
According to size of first-month purchases; table 127 ... 132
Number of customers, average purchases per customer, size of average order, average rate of turnover, bad debt losses, percentage of customers satisfactory, by type of business; comment and table 125 ... 131
Department stores:
Amount of total retail sales, amount and percent of department-store sales, estimated respectively by Foreign and Domestic Commerce Bureau and Bureau of the Census, 1929–39; table 10 ... 182

SALES EXPERIENCE—Continued.
Department stores—Continued. Page
Index of value of sales, 1929–40; comment and chart 5 ... 180–181
Net operating results: percentage of sales 1930–37, by size of business group; table 11 ... 182
Grocery stores:
Buffalo, independent stores, sales volume in 1933 and 1935, percent of 1929, by size of business in 1929; comment and table 43 ... 35
Buffalo, number of independent stores, percent of total stores, percent of total sales, 1929, 1933, 1935, by amount of sales; comment and table 42 ... 34
Buffalo, value of sales of independent stores in 1929, according to years of ownership, 1890–1929; comment and table 41 ... 33
Life span and sales ... 33–36
Mail-order houses:
Monthly average sales amount, 1929–40; comment and chart 7 ... 182–183
Manufacturing corporations:
Gross sales (or gross receipts from operations) in all manufacturing corporations submitting balance sheets, 1932 and 1935, by asset size: comment and table 14 ... 217
Meat retailers:
Pittsburgh; citation ... 116
Meat wholesalers:
Weekly sales to retailers: meat, grocer, combination, delicatessen, variations in amounts; table 112 ... 116
Packing houses:
Customer mortality, percentage lost and rate of customer turnover; table 114 ... 117
Number of customers served, number of orders sold, total dollar sales, number of orders per month, dollar sales per month, per order, 3 branch packing houses, 1926–30; table 113 ... 116
Products:
Products control analysis ... 124–126
Proportions of different products sold to small and large buyers by 4 wholesalers; comment and table 118 ... 124
Relationship of product expense to volume per item and per interview, 15 wholesalers, in percentages of average; comment and table 119 ... 125
Ratios of rent, pay roll and proprietor withdrawals. (*See* Costs of Operation.)
Retailers:
Percentage distribution of stores and average sales per store by size of stores, 1929, 1933, 1935; comment, table 7 and chart 2 ... 173–175
Trend analysis, 1929–30, percent of 1929 volume; comment and chart 1 ... 172–173
SALOONS: Life span: Poughkeepsie, N. Y., established between 1844 and 1926 years of life 1–10 and over, percentage distribution; table 17 ... 19
SAUNDERS, WILLIAM B., HAROLD VATTER, and HAROLD H. WEIN: Capital and credit problems of small business ... 207–243
SCRANTON and WILKES-BARRE, Pa.: Field survey of business conditions: financing devices employed in the community (anthracite coal, silk industry, field warehousing), the banks, community attempts at capital relief, capital for new enterprise ... 312–318
SEASONALITY: Liquidation ... 26
SEATTLE, WASH., and PORTLAND, OREG.: Business condition field survey: waning "big business" base, bases for new developments, manufacturing, need for "capital loans," Seattle banking situation, Portland: influence of branch banking, substitute forms of financing, experience of a community fund ... 333–341
SECRIST, HORACE: Expenses, profits, and losses in retail meat stores (1924); cited (n.) ... 106
SECURITIES:
Costs of flotation: manufacturing, extractive, merchandising, other business, 1936–37, by face value of issue; table 15 ... 292
Sales record of securities registered under securities Act of 1933 on Forms A–1 and AO–1 between July 27, 1933, and June 30, 1938:
By industry and size of issue; table 17 ... 294–295
By quarterly periods of effective registration; table 16 ... 293

Page

SELIGMAN, E. R. A.: Economics of installment selling (1927); cited (n.) 270

SERVICE ENTERPRISES:
- Births and deaths percentage distribution, January to June, 1936; table 83 64
- Corporations:
  - Poughkeepsie, percentage distribution, 1844–1927, of corporations compared with "all other" organization forms, 1 to 10 years and over, table 79 60
- Failure-mortality relationship:
  - Percentage of total deaths per failure, January 1936 to September 1937; table 82 64
- Failures:
  - Number of failures and amount of liabilities each year 1938 and 1937, cleaners and dyers, haulage, busses, taxis, hotels, laundries, undertakers, all others respectively; table 89 68
- Life span:
  - Minneapolis, St. Paul, Duluth, average number of years in business, 1926–30; compared with other business types; table 67 52
  - Poughkeepsie, 1844–1926, number established, number and percent distribution lasting 1 to 10 years and over, compared with other types of business; comment and tables 69–70 53–54
  - Poughkeepsie, 1844–1926, number of concerns established, number and percent lasting more than 20 years, compared with other types of business; table 71 54
  - Poughkeepsie, N. Y., enterprises established between 1844 and 1926, years of life 1–10 and over percentage distribution: Saloons, restaurants, express service; table 17 19
- Net worth:
  - Minneapolis, St. Paul, Duluth, number of firms in each net worth class, 1930; table 74 56
- Organization types:
  - Poughkeepsie, percentage distribution of 3,453 concerns by type of organization; table 78 60
- Population per establishment:
  - Poughkeepsie, 1842, 1873, 1903, 1933, compared with other types of business; comment and table 72 55
- Small and large businesses 217
- Small business characteristics 252
- Turnover:
  - Minneapolis, St. Paul, Duluth, percent firms closing and opening 1926–30; compared with other types of business; table 68 52
- Turnover-net worth relationship:
  - Minneapolis, St. Paul, Duluth, 5-year ratio, 1926–30; table 77 59
  - Minneapolis, St. Paul, Duluth, number of firms opened and closed, 1926–30; table 76 58

SHIFTING OF INDUSTRY. (*See* Location of Industry.)

SHOE CRAFTS:
- Life span:
  - Poughkeepsie, N. Y., years of life, 1–10 and over, of shoemakers established between 1844 and 1926; percentage distribution; table 16 19

SHOE MANUFACTURING CONCERNS:
- Capital requirements 92
- Life span:
  - Average longevity in sample area during period 1905–35 46
  - Relation to size of community 47–48

SHOE RETAILERS:
- Life expectancy:
  - Buffalo, years 1–10, 1920–28; table 53 42
  - Pittsburgh, years 1–10, 1925–33; table 52 42
- Life span:
  - Minneapolis, St. Paul and Duluth; 5-year turn-over ratio and average life in years, 1926–30; table 5 11
- Mortality:
  - Buffalo, 1918–27; percentage withdrawing each year; table 30 27
  - Pittsburgh, 1925–34, percentage withdrawing each year; table 31 27

SHOE RETAILERS—Continued.
Survival: Page
Enterprises in 32 county seat towns, 1915 and 1935, number of survivors 1935; table 6 — 12
SILK INDUSTRY:
Paterson, N. J., financing of small units, analysis and table 92 — 91–92
Scranton and Wilkes-Barre conditions — 313–314
SIZE OF BUSINESS ENTERPRISES:
Retailers, trend analysis, 1929–35; charts 1–2 and tables 6–7 — 172–176
Size distribution, statistics and discussion; by assets, by number of employees, by value of product — 283–285
Small business. *See* Small business.
Wholesalers trend: grocery, drug, dry goods, hardware, and electrical goods, analyzed as of 1929 and 1935, comment and tables 1 to 5 — 167–172
SIZE OF COMMUNITY:
Life span relationship:
Shoe manufacturing concerns — 47–48
SMALL BUSINESS:
Accounts financing companies, function and operation of — 270–272
Banking policy and needs of small business — 222–227
Capital and credit problems; by William B. Saunders, and others — 207–243
Capital cost:
Inequalities as between large and small firms; comment and table 16 — 219
Capital, credit and small business analysis (Nehemkis) — 261–279
Commercial bankers viewpoint on small enterprise loans — 363–364
Construction. (*See* Construction industry.)
Corporations:
Distribution of — 250
Net income corporations, proportion of income and of deficit corporations with less than $50,000 assets, respectively, to total income and deficit corporations; proportion of corporations with less than $50,000 assets to total number of corporations, 1931–36; comment and table 7 — 213
No-net income corporations, proportion of smallest and largest deficit corporations respectively to total corporations, 1931–36; comment and table 8 — 213–214
No-net income corporations, relationship of smallest deficit corporation to total corporations with and without net income, 1932–36; comment and table 9 — 214
Credit cost:
Commercial, national bank and business loans; comment and tables 17–20 — 220–221
Credit sources:
Commercial banks, Federal credit agencies, accounts financing companies, the factor, trade credit analysis (Nehemkis) — 265–276
Distribution of:
Number of small enterprises, numerical distribution according to size, marginal and part-time, nonemploying and employing, distribution in manufacturing, distribution of corporations; analysis (Nehemkis) — 248–251
Economic contributions of small business; comment and tables 7–24 — 290–302
Economic distribution:
Consumer service, contributions to big business, competition with big business, contribution to gainful employment; analysis (Nehemkis) — 256–259
Economic position — 211–222
Equity capital sources, individuals, investment banking, investment trusts (Nehemkis) — 262–265
Factor, servicing operation of — 272–274
Federal Reserve System loans — 231–236
Federal reserve banks, function as credit source — 270
Federal Housing Administration, function as credit source — 269
Financial problem; by Peter R. Nehemkis, Jr — 245–279
Financing:
English experience; Macmillan Committee report (1931); cited (n.) — 264
Equity capital sources: individuals, investment banking, investment trusts ((Nehemkis) — 262–265

SMALL BUSINESS—Continued.
Financing—Continued. Page
Equity capital sources: Government direct loan and insurance proposals 237–239
Industrial loan corporation, proposed in S. 2998, Seventy-sixth Congress 278
Investment banking, part of, in financing small business 263
Investment trusts, part of, in financing small business 264
Warehouse receipts 314
Government aids:
Equity capital, direct loan and insurance proposals 237–239
Government aid, program outlined 242–243
Government aids, in operation and suggested 227–239
Habitat of small business: distribution throughout major divisions and subdivisions of industry; comment and tables 5 and 6 286–288
Legislative proposals:
Discussed 277–279
Summary of bills bearing on the financing of small business introduced in the Seventy-sixth Congress 237, 364–370
Manufacturing concerns:
Distribution of 250
Ratios by size and kind of trade, analysis 253–255
Working capital, aggregate volume, amount and index (1929=100), 1926–36; comment and table 1 208
Mining and Quarrying: (*See* Mining and Quarrying Concerns.)
Prevalence and characteristics:
Trade, service, construction, manufacturing, mining and quarrying, transportation and public utilities; analysis (Nehemkis) 251–256
Reconstruction Finance Corporation:
Function as credit source 270
Loans 228–231, 234–236
References to literature. (*See above* References to Literature and Sources, items 25, 28, 69, 73.)
Service concerns. (*See* Service enterprises.)
Share of the market 216–218
Social viewpoint of problem, importance of 242
Trade credit, operation of 221–222, 274–276
Transportation. (*See* Transportation.)
Venture financing experiment: special study of speculative ventures by a group of Chicago businessmen 356–362
SOCIAL SECURITY BOARD: Old-age and survivors insurance tables compiled in 1939 281
SOLVENCY INDEX: Proposal (Fitzpatrick) 95
SOUTHEASTERN GOVERNORS' CONFERENCE: Invitation to industry to locate in Southeastern States 150
SPECULATIVE FINANCING. (*See* Venture Financing Experiments.)
SPOKANE, WASH.: Tenancy-business property fluctuations, square feet of rental area changes between October 1, 1938, and May 1, 1939; table 92 70–71
STANDARDIZATION: Factor in business mortality 141
STATE TRADE BARRIERS. (*See above* Interstate and Intrastate Commerce Regulations.)
STATIONERY AND ART RETAILERS:
Life span: Minneapolis, St. Paul, and Duluth; 5-year turn-over ratio and average life in years, 1926–30; table 5 11
STONE, CLAY, AND GLASS MANUFACTURING CONCERNS:
Failures, number of failures, amount of liabilities, each year 1938 and 1937; table 89 68
STRONG, DR. EARL D.: Resale price maintenance, an economic summary 189–203
SUPER MARKETS: Food field 179–180
Relation to life span of chain units 40–41
SURVIVAL:
Defined 4
Grocery stores, summary 15–18
Retail concerns:
Enterprises in 32 county seat towns, by trade, 1915, number of survivors, 1935; comment and table 6 12

SURVIVAL—Continued.
Types of business: Page
Poughkeepsie, 1844–1927, percent surviving, respectively, retail, service, manufacturing, and wholesale 53
SWARTZ, CHRISTIAN L., *joint author.* (*See* Lowry, William.)
TAILORS' CRAFT:
Life span: Poughkeepsie, N. Y., years of life, 1 to 10 years and over, of tailors established between 1844 and 1926; percentage distribution; table 16 19
TAX EXEMPTION:
Louisiana 151
Mississippi 152
TAYLOR, GEORGE R., *and others.* Barriers to internal trade in farm products (1939); cited (n.) 145
TEELE, STANLEY F.: Expenses, profits, and losses in retail meat stores (1924); cited (n.) 113
TENANCY:
Fluctuation:
Square feet of rental area changes between October 1, 1938, and May 1, 1939, in 16 named cities; comment and table 92 70–71
TENNESSEE. (*See* Memphis, Tenn.)
TEXAS. (*See* Austin, Houston, Dallas, and Fort Worth.)
TEXTILE MANUFACTURING CONCERNS:
Failures:
Number of failures, amount of liabilities, each year, 1938, and 1937; table 89 68
Profits:
Percentage of total capital, 1924–28; table 13 186
Ratio of compiled net profit (after tax) to net worth (average equity), average 1931–36, by size of asset class; table 11 215
THOMAS, W.: The banks and idle money (1940); cited (n.) 269
THORP, WILLARD L.: Changing distribution channels (1939); cited (n.) and extract 121, 160, 178
Changing structure of industry (1929); cited (n.) 79, 118
Foreword to Part II. "Market security and price stability" 157
Trend of failures in the distribution field (1938); cited (n.) and extract 20, 82
TRADE BARRIERS. (*See above* Interstate and Intrastate Commerce Regulation.)
TRADE CREDIT: Small business servicing 274–76
TRANSPORTATION: Small business characteristics analysis (Nehemkis) 256
TURNOVER:
Business population:
Causes of numerical changes, general analysis 63–71
Minneapolis, St. Paul, Duluth, percent firms closing and opening, 1926–30, by type of business; comment and table 68 52
Number of enterprises, new and discontinued enterprises, number and percent, 1930–36; table 13 291
Number of listed enterprises, new and discontinued enterprises, each year 1900–1938; comment and table 86 66
Percentage distribution of entries and closures of concerns in business, each year 1920–36; table 87 66
Corporation finance, defined 218
Customer turn-over, meat wholesaler. (*See* Sales Experience.)
Defined 4
Grocery stores:
Boston, Mass., closing and opening rates for chain stores, 1929–30; number of stores first of year, number closed in year, number added in year, net change, number stores in business during year, turn-over rate 2 to 5, closing rate 2 to 1, opening rate 3 to 1, average number of stores during year, turn-over 2 to 9; table 15 18
Meat markets:
Chicago, rate of turn-over of meat markets and combination stores, respectively, 1921–33, comment and table 18 19–20